CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 2 EXAMINATIONS

A2.2: STRATEGIC PERFORMANCE MANAGEMENT

DATE: THURSDAY 24, AUGUST 2023

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking Guide

a) i) Under Life cycle costing, calculate the cost attributable to each wheelbarrow

Marketing costs	0.5
Research and Development Costs	0.5
Production cost per unit	0.5
Customer service costs per unit	0.5
Total cost	0.5
Cost per unit	0.5
Maximum marks	3

ii) How much profit will Karekezi Holdings Ltd earn per wheelbarrow

Profit per wheelbarrow (1 Mark only)	1

iii) Advise the Chief Finance Officer the best course of action for Karekezi Holding Ltd in regard to the management accountant's view

Lifecycle costing worthwhile (1 Mark only)	1

b) Describe two approaches to the management of ethics within KHL as suggested by lynne Paine.

A compliance-based approach	2
An integrity-based approach	2
(2 Marks on each well explained approach with corresponding features)	
Maximum marks	4

c) ISIMBI Supermarket is considering re-engineering its processes; examine the features that would indicate a re-engineered process in reference to ISIMBI Supermarket

Define BPR	1
Combine several jobs	1
Logical framework	1
Cleaning time	1
Quality control system	1
Operations Manager takes the lead	1
Centralisation of the supermarket management	1
Any other valid point to score 1 Mark	1
Maximum Marks	6

d) Merely developing a code is never considered sufficient: discuss the impact of developing and implementing a code of conduct at KHL Ltd

Senior management commitment	2

Behavioural change 2

Behaviour discouragement 2

Detailed statement 2

Buy-in 2

Any other valid impact to score 2 Marks 2

Maximum Marks 10

e) Five stages of a product life cycle

Introduction stage (Each 2 Marks is awarded to a well explained point with an eg.) 2

Growth stage 2

Maturity stage 2

Saturation stage 2

Decline stage 2

Maximum Marks 10

f) What are some of the implications of life cycle costing on pricing, performance management and decision making.

Reporting 1

Enhanced visibility 1

Profitability understood 1

Accurate information 1

Any other valid implication 1

Maximum Marks 4

g) Discuss five advantages and five disadvantages of deploying an ABC methodology at KHL

Advantges

Identification of change cost factors 1

Better basis for cost apportionment 1

Overheads are traced to the product 1

More realistic and accurate product costs 1

Improves decision making 1

Attention to cost behaviour 1

Any other valid advantage 1

Maximum Marks 5

Disadvantages 1

Difficulties that emerge 1

Disadvantage to smaller organisations 1

Several cost pools and cost drivers 1

Technology level 1

Time 1

Fashion based 1

Any other valid advantage 1

Maximum Marks 5

(Total: 50 Marks)

Model Answers

Karekezi Holdings Ltd

Particulars	Amounts in FRW					
	Year 1	Year 2	Year 3	Year 4	Year 5	Totals
Marketing costs	85,000	40,000	120,000	130,000	150,000	525,000
Research and development costs	2,500,000	300,000	240,000	200,000	-	3,240,000
Production costs	10,500,000	10,400,000	6,840,000	6,150,000	4,050,000	37,940,000
Customer service costs	1,050,000	700,000	720,000	675,000	450,000	3,595,000
Disposal of the equipment costs					1,000,000	1,000,000
Total cost						**46,300,000**
No of units						97,000
Cost per unit = (46,300,000/ 97,000)						477
Profit per wheel barrow						
Estimated selling price						600
Cost per unit						477
Profit = (600 – 477)						**123**

iii) Given that each wheelbarrow makes a profit of FRW 123 then it is worthwhile to consider life cycle costing while determining the selling price of the wheelbarrows though the profit appears really marginal.

b) The two approaches to the management of ethics within an organisation as suggested by lynne Paine.

A compliance-based approach: This is an approach purely designed to ensure that all KHL staff act within the letter of the law. The drawback to this approach is that by just complying with the law, cannot be an adequate means to which a full range of day-to-day organisational ethical issues could be addressed. KHL will need to abide by the law though this might not stop officers from being unethical.

An integrity-based approach: This approach combines the letter of the law along with an emphasis on managerial responsibility to behave ethically. The benefit with this approach is that once it is integrated into KHL's day to day operations, it helps in mitigating ethical lapses. KHL will need to develop a code of conduct but complement it with managerial buy-in and responsibility.

c) ISIMBI Supermarket is considering re-engineering its processes; examine the features that would indicate a re-engineered process in reference to ISIMBI Supermarket.

BPR may be defined as the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical contemporary measures of performance such as quality, cost, service and speed.

ISIMBI supermarket would have to combine several jobs into one at each super market branch especially staff in charge of quality control and those in charge of recording deliveries should be the same person.

ISIMBI should come up with a logical framework through which each process has to be performed i.e., from requisition to order placing, then to inspection upon arrival and receiving and registering deliveries into inventory etc

ISIMBI should not waste a lot of time cleaning the supermarket. In as much as cleaning is important, it should be noted that under BPR work is performed where it makes most sense. Besides, cleaning can either be done early morning or at night before concerned staff depart.

ISIMBI may also have to consider establishing a system of quality control such that poor quality products do not have to go beyond the quality control check point to avoid humiliation by customers.

It will be important that going forward, the Operations Manager takes the lead in managing the supermarkets and reports back to the CEO as opposed to both of them running the supermarkets without a clear chain of command.

Centralisation of the supermarket management may also offer other benefits such as economies of scale that would be very important while dealing with suppliers including negotiation of supplier contracts.

Processes at ISIMBI should be designed to achieve a desired outcome rather than focusing on existing tasks. For example, Point of Sale at the counters should be increased to reduce on longer queues or implement other payment modes such that customers may be able to enjoy flexibility of choice.

d) Merely developing a code is never considered sufficient: discuss the impact of developing and implementing a code of conduct at KHL Ltd.

A code of conduct contains a series of statements setting out company's values including explaining how it responds and addresses various stakeholder issues.

Senior management commitment – with a code at KHL, the commitment of the senior management team shall be enhanced and with this, the code shall help management to persuade the staff that expectations have since changed.

Behavioural change – Better still, staff will also be facilitated to understand that it is in the KHL's interest to change behaviour, by also committing to the same ideals.

Behaviour discouragement – Measures that conflict with the previous behaviour at KHL just before the code was introduced, shall henceforth be discouraged.

Detailed statement – Apart from the general code of conduct, a more detailed statements (codes of practice) will need to be developed setting out formal procedures that must be followed.

Buy-in – Like any other organisation's new policy, the code of conduct may not be perceived the same way by all the staff as it may be perceived to have a limitation either to their earnings or job freedom.

e) Five stages of a product life cycle

The product life cycle – This refers to a process through which a product undergoes from the time it is launched until it dies out. The process is made up of five stages:

Introduction stage – This is a stage where a product is characterized with no profit as a result of being launched. At this level, competition is either non-existent or limited though with high growth levels. In KHL Ltd the introduction would be the first year were it is equally indicated that KHL would be incurring losses as in that stage, sales are very limited yet some costs would have been already incurred in form of research and development costs among others.

Growth stage – At this level, profits start to emerge to cover a bit of expenses incurred at the introductory level, attributed to the products being accepted at the market in bigger numbers. Year two would be the growth stage at KHL Ltd as profits will have emerged with possibilities of increasing the market share.

Maturity stage - At this level, there is stiff market competition with various players coming up with diverse marketing strategies including advertising, promotional campaigns that attract the use and rewarding of loyalties. As the third year is characterised with more players entering into the market, it is an indication of product maturity and therefore KHL Ltd will need to devise means of fighting the competition.

Saturation stage – At this level, sales growth appears to be in decline which leads to a lower profit per unit as more competitors join the market. With sales declining rapidly in the fourth year, the wheel barrows shall have reached the saturation stage, a sign that competitors will be owning a bigger portion of the market.

Decline stage – This is the last level of the product life cycle characterized with a slow but accelerated decline in sales and profits. For some players this is the time that they may have to start thinking about product withdrawal. If KHL Ltd is considering withdrawing out of the market, it's a sign that wheel barrows will have reached the decline stage. After all, if the wheel barrows had been estimated to have a life cycle of five years; it would be high time KHL Ltd considered discontinuing the wheel barrow product and concentrate on the super market business.

f) What are some of the implications of life cycle costing on pricing, performance management and decision making.

Since non production costs are attributed to individual products over the wheel barrows life cycle this may result into:

Reporting - the total of these costs for each wheel barrow are able to be reported and revenues to be generated for the future and equally compared instantly.

Enhanced visibility – The visibility of wheel barrow costs that have been accustomed to life cycle costing increases at KHL Ltd to facilitate decision making. For example, the FRW 150,000 in year 5 as a marketing cost may be ignored since the product shall be at a decline stage, almost at a point of withdrawal and therefore management may decide to save that expense.

Profitability understood – Each wheel barrow profitability can be better understood by attributing all costs to wheel barrows and a decision made in case of unfavourable circumstances.

Accurate information – KHL Ltd will be able to access accurate information fundamental for its future growth as the information and the decision is made early enough.

Reduced product cost – being able to plan, design and develop a product at such an early stage improves an organisation's cost management process, a move that contributes to cost reduction thereby providing an opportunity for the organisation to effectively compete in the market.

Additionally;

Under pricing, As Life Cycle Costing (LCC) considers all costs of a products from its introductory to its decline stage, there would be much probability of considering all costs over its life. As a result, this would help to know the accurate total costs of a products, hence helps in setting up its related selling price. This will therefore avoid under/over pricing of this product.

Under performance management, after knowing or ascertaining product's total costs and price, KHL will identify profitable and loss-making product, this will help to measure the performance of its product over its life.

Under Decision making, As LCC helps to know total costs, price and product performance, this will help KHL to decide on the products to be dropped, continued as per its performance and contribution as well.

g) Discuss five advantages and five disadvantages of deploying an ABC methodology at KHL Ltd

Advantages of ABC at KHL Ltd

ABC is a costing technique that involves the identification of the factors which cause the costs of an organisation's main activities to change based on the usage levels.

Better basis for cost apportionment by identifying the real nature of cost behaviour which will help KHL Ltd in reducing costs and identifying activities which do not add value to the product as emphasised by the Chief Finance Officer.

Overheads will be better traced at KHL Ltd to the wheelbarrows which increases a better understanding of the overhead costs and cost drivers.

A more realistic and accurate product costs shall be realised at KHL Ltd thereby leading to a more accurate pricing decision. This is supported by accuracy and reliability in the wheelbarrow cost determination by focusing on cause-and-effect relationship in the cost incurrence.

ABC will influence KHL Ltd's managers to consider the drivers of cost within their businesses which greatly improves the manager's decision making as they can use more reliable product cost data.

ABC will provide a useful means of getting financial and non-financial data by tracing costs to areas of managerial responsibility, processes, customers, departments besides the product costs.

ABC will bring attention to cost behaviour and also help in the reduction of costs by comparing the resources required under ABC with the resources that are currently provided with life cycle costing and other costing methods.

ii) Disadvantages of ABC at KHL Ltd

There are difficulties that emerge during the implementation of the ABC system such as picking cost drivers and varying cost driver rates. In order to implement ABC at KHL Ltd, will require identification of all cost drivers and this appears challenging.

Disadvantage to KHL Ltd: ABC has different levels of utility for different organisations such as large manufacturing firms which can use it more usefully than the size of KHL Ltd. For example, KHL Ltd may be better off using life cycle costing as opposed to ABC.

A full ABC system having several cost pools and cost drivers is more complex and more expensive to operate than traditional product costing systems. KHL Ltd might not find it worthwhile therefore.

Technology level: The level of technology and manufacturing environment prevailing in different firms also affect the application of ABC. It appears the technology at KHL Ltd might not be favoured by ABC.

Time: The ABC system is very time consuming as it requires management to estimate costs of activity pools and to identify and measure cost drivers to serve as cost allocation bases which involves so many calculations to determine costs of wheelbarrows which KHL Ltd appears not to have and ready for.

Fashion based: Some organisations may just decide to deploy ABC because it is fashionable not because KHL Ltd really needs it to make informed product costing decisions. In such cases therefore, it may be better to use absorption costing or life cycle costing which is cheaper and more cost effective as opposed to sticking to ABC.

SECTION B

QUESTION TWO

	Details	Marks
a	Stages of scenario planning Award 0.5 Marks to each well explained point, max 2.5 marks	**2.5**
b	Revenues	1
	Variable costs	1
	Depreciation on equipment	1
	Marketing and distribution costs	1
	General administration costs	1
	Corporate office costs	1
	Operating income (loss)	1
	Conclusion	1
	Maximum	**8**
c	Revenues	1
	Variable costs	1
	Depreciation on equipment written off as depreciation	1
	Marketing and distribution costs	1
	General administration costs	1
	Corporate office costs	1
	Operating income (loss)	1
	Conclusion	1
	Maximum	**8**
d	Revenues	1
	Variable costs	1
	Equipment cost written off as depreciation	1
	Marketing and distribution costs	1
	Division general administration costs	1
	Corporate office costs	1
	Effect on operating income (loss)	0.5
	Maximum	**6.5**
	Total	**25**

Model Answers

(a) Stages through which HDT Co Ltd would go through while performing the scenario planning

Nowadays, the complexity of the external environment makes it difficult for organizations to predict the future. However, to help them plan and assess potential opportunities and threats, firms can develop scenarios based on the key influences and change drivers in the environment. Constructing plausible views of how the business environment of an organization might develop in the future, based on sets of key drivers for change.

Scenarios are not forecasts and predictions, but are plausible views of possible future conditions. The aim of scenario planning is to learn rather than predict the future, so organizations are often advised to produce multiple scenarios, to maximize the learning and contingency planning if necessary. Scenarios can be developed at a macro-environmental level (i.e relating to changes in PESTEL factors) or an industry level (ie relating to Porter's five forces).

The following are the stages through which HDT Co Ltd would go while performing the scenario planning:

1. HDT Co Ltd would identify the scope including the timeframe to be involved, product line to be considered either telephone or computer, and who are the major stakeholders to be involved,
2. HDT Co Ltd would identify the key trends and areas of uncertainty based for example on Political, Economic, Social, Technological and Legal factors,
3. HDT Co Ltd would then construct the initial scenarios based on the key areas of uncertainty identified in stage two above,
4. HDT Co Ltd would then check the scenario for consistency and plausibility,
5. HTD Co Ltd would expand the initial scenarios into full descriptions as if the scenario was actually occurring in order for management to assess the implications each scenario could have on the organization,
6. Develop quantitative models of the effect of different scenarios on the organization's activities and profitability or cash flow
7. Develop strategies or courses of action which could be adopted in different scenarios if they actually happen

(b) The incremental revenue or losses by discontinuing the Tables product line follows:

Details	**Amount (FRW'000)**
Revenues (FRW 125,000*4,000 Telephones)	(500,000)
Variable costs (FRW 75,000*4,000 telephones)	300,000
Depreciation on equipment	0
Marketing and distribution costs	70,000
General administration costs	0
Corporate office costs	0
Total costs	**370,000**
Operating income (loss)	**(130,000)**

By discontinuing the telephone product line, it will result in revenue losses of FRW 500,000,000 and cost savings of FRW 370,000,000. Hence, High-Definition Technology company (HDT Co) Ltd.'s operating income will be FRW 130,000,000 lower if it discontinues the telephone line.

Note that, by discontinuing the telephone product line, HDT Co Ltd will save none of the depreciation on equipment, general administration costs, and corporate office costs, but it will save variable costs and all marketing and distribution costs on the telephone product line.

(c) HDT Co Ltd will generate incremental operating income of FRW128,000,000 from selling 4,000 additional telephones and, as a results, it should try to increase telephone sales. The calculations are as follow:

Details	**Amount (FRW'000)**
Revenues (FRW 125,000*4,000 Telephones)	500,000
Variable costs (FRW 75,000*4,000 telephones)	(300,000)
Depreciation on equipment written off as depreciation	(42,000)
Marketing and distribution costs (FRW750,000*40 shipments)	(30,000)
General administration costs	0
Corporate office costs	0
Total costs	**(372,000)**
Operating income (loss)	**128,000**

The additional costs of equipment are relevant future costs for the "selling more telephones decision" because they represent incremental future costs that differ between the alternatives of selling and not selling additional telephones.

Current marketing and distribution costs which varies with number of shipments FRW 750,000*40 telephone shipments = FRW 30,000,000. As the sales of telephones double, the number of shipments will double, resulting in incremental marketing and distribution costs of FRW 30,000,000.

General administration and corporate office costs will be unaffected if HDT Co Ltd decides to sell more telephones. Hence, these costs are irrelevant for this particular decision.

(d)

Details	**Telephones (FRW'000)**	**Computers (FRW'000)**	**Total (FRW'000)**
Revenues	500,000	1,000,000	1,500,000
Variable costs	300,000	525,000	825,000
Equipment cost written off as depreciation			100,000
Marketing and distribution costs	70,000	135,000	205,000
Division general administration costs	110,000	220,000	330,000
Corporate office costs	-	-	-
Total costs	**480,000**	**880,000**	**1,460,000**
Effect on operating income (loss)	**20,000**	**120,000**	**40,000**

HDT Co Ltd should open the Musanze Branch because it would increase operating income by FRW 40,000 (increase in relevant revenues of FRW 1,500,000 and increase in relevant costs of FRW1,460,000). The relevant costs include direct materials, direct manufacturing labor, marketing and distribution, equipment, and division general administration costs but not corporate office costs. Note, in particular, that the cost of equipment written off as depreciation is relevant because it is an expected future cost that HDT Co Ltd will incur only if it opens the Kigali branch. Corporate office costs are irrelevant because actual corporate office costs will not change if HDT Co Ltd opens the Musanze branch. The current corporate staff will be able to oversee the Southern Division's operations. Grossman will allocate some corporate office costs to the Southern Division but this allocation represents corporate office costs that are already currently being allocated to some other division. Because actual total corporate office costs do not change, they are irrelevant to the division.

QUESTION THREE

	Details	**Marks**
i	Market share Every component of a variance should be given 0.5 marks, max 2 marks	2
	Market size Every component of a variance should be given 0.5 marks, max 2 marks	2
	Comment	1
	Maximum	**5**
ii	Planning material variance Every component of a variance should be given 0.5 marks, max 3.5 marks	3.5
	Operational material variance Every component of a variance should be given 0.5 marks, max 3.5 marks	3.5
	Maximum	**7**
iii	Planning labour efficiency variance Every component of a variance should be given 0.5 marks, max 3.5 marks	3.5
	Operational labour efficiency variance Every component of a variance should be given 0.5 marks, max 3.5 marks	3.5
	Maximum	**7**
iv	Assessing the use of standard costing and variance analysis in RMB Ltd Award 1 mark to each well explained point max 5 marks and 1 mark for memo presentation	6
	Total	**25**

Model Answers

i. Using the traditional sales volume variance method, the variance will be given by: (Actual units sold - Budgeted sales) * Standard profit per unit: (900,000 – 800,000) *FRW6,000 = FRW600million F

Planning and operational variances

The revised budget would show that RMB Ltd should expect to sell 25% of 3.5 million units = 875,000 units.

Details	Formula	FRW (000)
Original sales* standard margin	800,000 * FRW6,000	4,800,000
Revised sales * standard margin	875,000 × FRW6,000	5,250,000
Market size		**450,000F**

Details	Formula	FRW (000)
Revised sales * standard margin	875,000 × FRW6,000	5,250,000
Actual sales * standard margin	900,000 × FRW6,000	5,400,000
Market Share		**150,000F**

Then, the total sales volume variance will be given by adding up market size and share which will be FRW 450 million and FRW 150 million and totalling 600 million favourable as calculated in the traditional sales volume variance calculations above.

Comment:

Most of the favorable variance can be attributed to the increase in overall market size. However, some can be put down to effort by the sales force which has increased its share from 25% to 25.7% (900,000/ 3,500,000).

Managers of RMB Ltd should therefore only be appraised based on the operational variance, i.e. the market share variance as they market size is out of their controls.

ii. **Calculation of material planning and operational variances**

From the scenario, we have been given the following information:

		Units
Budgeted production and sales		60,000
Actual production and sales		48,000
Actual material used and purchased		109,120
	New bag	**Old bag**
Standard price per meter	3,150	3,281
Standard quantity per bag (meters)	4.4	4
Labor hours per bag-Minutes	15	10

SQAP (standard quantity for actual production)	4 meters*48,000	192,000 meters
RQAP (revised quantity for actual production)	4.4 meters*48,000	211,200 meters

From the scenario the actual production level (AP) is 48,000 bags and actual quantity of material bought and used (AQ) is 109,120 meters.

Material price variances			FRW
Planning variance	(SP -RP) * AQ	(FRW3,281-FRW3,150) * 109,120	14,294,720F
Operational variance	(RP -AP) * AQ	(FRW3,150 - FRW3,150) * 109,120	-
Total price variance			**14,294,720F**

Material usage variances			FRW
Planning variance	(SQAP - RQAP) * SP	(192,000 - 211,200) * FRW3,281	62,995,200A
Operational variance	(RQAP -AQ) * SP	(211,200 -109,120) * FRW3,281	334,924,480 F
Total usage variance			**271,929,280 F**
Total material variance			**286,224,000 F**

iii. **Calculation of labor efficiency planning and operational variances**

AH (actual hours worked and paid)	48staff * 8 hours a day*5days*4weeks	7680 hours
SHAP (standard hours for actual production)	(48,000 * 10minutes)/60minutes	8000 hours
RHAP (revised hours for actual production)	(48,000 * 15minutes)/60mimnutes	12000 hours

From the scenario the standard rate per hour (SR) is FRW12,000, the standard time per dress is 10 minutes and the revised time per dress is 15 minutes.

Labor efficiency variances			FRW
Planning variance	(SHAP - RHAP) * SR	(8000- 12000) * FRW12,000	48,000,000 A
Operational variance	(RHAP - AH) * SR	(12000 -7680) * FRW12,000	51,840,000 F
Total labor efficiency variance			**3,840,000F**

iv. By Considering the production environment of RMB Ltd, the following is the critical assessment on the use of standard costing and variance analysis in RMB Ltd

MEMO

From: Management accountant
To: Chief Executive Officer,
Date:01/01/2020

Re: critical assessment on the use of standard costing and variance analysis in RMB Ltd

The standard costing and variance analysis have been very popular performance measurement in manufacturing industry. Nowadays, as the technology evolves, the use of traditional budgetary systems and variance analysis as a measure of performance are not appropriate due to the continuing improvement in technology and other factors including but not limited to the following:

1. **Non-standard product:** Nowadays, many modern manufacturing industries like RMB have no standard products, the company design and produce a product depending on the clients' specific specifications. Therefore, the products differ and are customized depending on the preference of a particular client. This makes the use of traditional standard costing system and variance analysis very hard to be used in the manufacturing environment like this.
2. **Standard costs card can be outdated quickly:** In RMB Ltd, there is an innovation and research department which should ensure the new method of producing bags. This make standard costing system very hard to be used because the company keeps changing the design, inputs requirements et. Therefore, the continual update of standard cost card as designs and costs change can be cost full in both terms of finance and time
3. **RMB Ltd production processes are very automated:** It is doubtful whether standard costing system is of much value for performance setting and controlling an automated manufacturing environment like that of RMB Ltd. There is an underlying assumption in standard costing that control can be exercised by concentrating on the efficiency of the workforce. Direct labor efficiency standards are seen as the key to management control. However, in RMB Ltd, there is a technological manufacturing processes where the rates of production output and material consumption are controlled by the machinery rather than the workforce.
4. **Ideal standard used:** Variance are the difference between actual and standard performance, measured in cost terms. The significance of variances for management control purposes depends on the type of standard cost used. RMB Ltd adopts JIT ns TQM systems, businesses often implement an ideal standard due to the emphasis on continuous improvement and high quality. Therefore, adverse variances with an ideal standard have a different meaning from adverse variances calculated with a current standard.
5. **Emphasis on continuous improvement:** As it is emphasized in the scenario, RMB Ltd adopted the JIT and TQM system. Standard costing and adherence to a preset standard is inconsistent with those system as applied in RMB Ltd.
6. **Monitoring performance is important:** Variance analysis control reports tend to be made available to managers at the end of a reporting period like a week, month, quarter or a year. In the modern manufacturing environment like that of RMB Ltd, managers need more real time information about events as they occur.

7. **Detailed information is required:** Variance analysis is often carried out on an aggregate basis (total material usage variance, total labor efficiency variance etc..) but in a complex and constantly changing business environment like that of RMB Ltd, more detailed information is required for effective management control which variance analysis does not provide.

Standard costing system and variance analysis is a key management and performance tool across many sectors mostly in the manufacturing sector. These factors do not mean that modern manufacturing industries are not using this system anymore or are out of use completely. The idea is for the efficiency and effective performance the modern and highly changing environment are changing and the use of standard costing system and variance are being gradually being little used.

Management Accountant.

QUESTION FOUR

Marking Guide

a) **Determine what should be the transfer price for each product unit if the total labour hours are limited to 6000 hours at SIMEX**

Hours required to meet maximum demand

Uni	0.5	
Una	0.5	
Uno		0.5
Total hours		0.5
Contribution per unit		1
Contribution per labour hour		1
Priority for selling		1
Uni hours (balancing figure: 650)		1
Benefit foregone		2
Transfer price for Una		1
Decision		1
Maximum Marks		10

b) Examine the ideal approach that would be able to provide goal congruent opportunities to all the profit centres.

Define negotiated transfer pricing and provide an example	2
Submission of plans	2
Arrange budget transfers between subsidiaries	2
Seek for opinion in case of non-agreement	2
Finalise the budget	2
SIMEX monitoring profit performance	2
Any other valid approach	2
Maximum Marks	12

c) **Value Based Management is considered to be a philosophy about corporate value: interpret the difference between value-based management and value mindset.**

VBM interpreted	1
Value mindset interpreted	1
Linkage	1
Maximum Marks	3

Model Answers

a) Determine what should be the transfer price for each product unit if the total labour hours are limited to 6000 hours at SIMEX.

Solution:	Hours	* Demand	Total
Uni	4	800	3200
Una	5	500	2500
Uno	3	300	900
Total Hours			6600

Contribution from external sales	Uni	Una	Uno
Contribution per unit	13,000	18,000	14,000 (35,000 – 22,000)
Labour hours per unit	4	5	3
Contribution per labour hour	3250	3600	4,667 (13,000/2)
Priority for selling	3	2	1
Total hours needed	3200	2500	900 = 6,600

If labour hours are limited to 6000

Uno	300	3	900
Una	500	5	2500
Uni	650	4	2600
			6000

In order to transfer the 400 units of Una to SIMAKO means foregoing the sale of 650 Units of Uni as 2600 hours would be need to make the transferred units.

Therefore, the opportunity cost of transferring a unit of Uni and the appropriate transfer price is as follows:

FRW per unit	
Variable cost of making Una	14,000
Opportunity cost: benefit foregone (3250*5)	16,250
Transfer price for Uni	**30,250**

The transfer price for the Uni should be FRW 30,250 which is less than the external market price of FRW 32,000.

b) Examining the ideal approach that would be able to provide goal congruence opportunities to all the profit centres.

Negotiated transfer pricing

This is a transfer pricing method adopted as a result of failure to identify an opportunity cost mainly attributable to lack of information about costs and revenues in the concerned individual divisions. This therefore calls for both divisional managers to negotiate the most appropriate price whilst identifying opportunities for improving profits beneficial for both divisions.

The ideal approach that would be able to provide goal congruent opportunities to SIMEX and its subsidiaries is as follows:

Both subsidiaries would need to submit plans for output and sales to SIMEX Ltd as a starting point to facilitate annual budget preparation.

SIMEX will review them along with any other information available at its disposal with any amendment requiring consent with the subsidiary managers.

Once SIMEX is happy with the plans, assuming they will have been found consistent with each subsidiary, SIMEX will then let subsidiary managers arrange budgeted transfers and transfer prices. If they are not there, SIMEX would need to establish a plan that would maximise profits as a whole with emphasise that both subsidiaries negotiate their prices based on SIMEX's plan.

If the subsidiary managers fail to agree a transfer price between themselves, they would then seek for an opinion or decision from SIMEX.

With SIMEX intervention, subsidiaries will be able to finalise their budgets within the agreed transfer price and resource constraint framework, while SIMEX will be doing the monitoring role regarding each subsidiary's profit performance.

c) Interpret the difference between value-based management and value mindset

VBM is a management approach that aligns an organisation's overall aspirations, analytical techniques, and management processes with the key drivers of value. For example, the performance measure adopted by an organisation is used in creating value throughout the organisation and equally embedded into its organisational culture.

Value mindset requires companies to focus enough on value creation by combining both financial and non-financial goals in order to have a balanced approach to performance review and measurement including senior managers possessing a solid analytical understanding of which performance variables drive the value of an organisation.

Linkage at the different levels of the organisation has to be seen in order to maximise organisational value: For the CEO, the objective may be stated as value creation measured in financial terms; Operations Director may want to focus on operational measures such as cycle time, cost per unit, defect rate etc; while the Marketing Director, may want to focus on customer service issues.

END OF MARKING GUIDE AND MODEL ANSWERS