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P1 Management Accounting

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QUESTION NO: 1

A company produces a product that requires two materials, Material A and Material B. Details of the material quantities and costs for August are given in the table below.

	Material A		Material B	
	Budget	Actual	Budget	Actual
Quantity (kg)	24,000	23,000	36,000	38,000
Cost per kg	\$2.40	\$2.30	\$1.30	\$1.38

Budgeted and actual output of the product for August was 12,000 units.

The material mix variance for August is:

- A. \$ 1, 540 Favourable
- B. Details of the material quantities and costs for August are given in the table below.

	Material A		Material B	
	Budget	Actual	Budget	Actual
Quantity (kg)	24,000	23,000	36,000	38,000
Cost per kg	\$2.40	\$2.30	\$1.30	\$1.38

Budgeted and actual output of the product for August was 12,000 units.

The material mix variance for August is:

- \$ 1, 540 Adverse
- C. \$ 1, 288 Favourable
- D. \$ 1, 540 Adverse

ANSWER: A

QUESTION NO: 2

TP makes wedding cakes that are sold to specialist retail outlets which decorate the cakes according to the customers' specific requirements. The standard cost per unit of its most popular cake is as follows:

		\$
Direct material:		
Ingredient A	4 kg at \$25 per kg	100
Ingredient B	3 kg at \$22 per kg	66
Ingredient C	2 kg at \$11.50 per kg	23
Direct labour	3 hours at \$12 per hour	36
Variable overhead	3 hours at \$8 per hour	<u>24</u>
Standard cost		<u>249</u>

The budgeted production for the period was 10,000 units.

Actual results for the period were as follows:

Production (units)		9,000
		\$
Direct material:		
Ingredient A	35,000 kg	910,000
Ingredient B	28,000 kg	630,000
Ingredient C	27,000 kg	296,000
Direct labour	30,000 hours	385,000
Variable overhead		230,000

The general market prices at the time of purchase for Ingredient A and Ingredient B were \$23 per kg and \$20 per kg respectively. TP operates a JIT purchasing system for ingredients and a JIT production system; therefore, there was no inventory during the period.

Discuss the usefulness of the planning and operational variances calculated for TP's management. Select ALL the TRUE statements.

- A.** The use of planning and operational variances will enable TP's management to draw a distinction between variances caused by factors extraneous to the business and planning errors (planning variances) and variances caused by factors that are within the control of management (operational variances).
- B.** The purchasing manager's performance can't be compared with the adjusted standards that reflect the conditions the manager actually operated under during the reporting period.
- C.** If planning and operational variances are not distinguished, there is potential for dysfunctional behavior especially where the manager has been operating efficiently and performance is being judged by factors outside the manager's control. In the case of TP it became evident during the period that the prevailing market prices for materials were significantly less than those set during the budget process.
- D.** Where a revision of standards is required due to environmental changes that were not foreseeable at the time the budget was prepared, the planning variances are controllable.
- E.** Standards that failed to anticipate known market trends when they were set will reflect faulty standard setting.

ANSWER: A C E

QUESTION NO: 3

Explain the advantages of management participation in budget setting and the potential problems that may arise in the use of the resulting budget as a control mechanism.

Select all the correct answers.

- A.** A purposes of budgeting is to act as a control mechanism, with actual results being compared against budget.

- B. Another purpose of a budget is to set targets to motivate managers and optimize their performance.
- C. The participation of managers in the budget setting process has several advantages. Managers are more likely to be motivated to achieve the target if they have participated in setting process has several advantages. managers are more likely to be motivated to achieve the target if they have participated in setting the target.
- D. Participation in budget setting can reduce the information asymmetry gap that can arise when targets are imposed by senior management. Imposed targets are likely to make managers feel demotivated and alienated and result in poor performance.
- E. Participation in budget setting can cause problems; in particular, managers may attempt to negotiate budgets that they feel are easy to achieve which gives rise to “budget padding” or budgetary slack.
- F. Managers will not ‘empire build’ because they don’t believe that the size of their budget reflects their importance within the organization.

ANSWER: A B C D E

QUESTION NO: 4

A marketing manager is trying to decide which of four potential selling prices to charge for a new product. The state of the economy is uncertain and may show signs of recession, growth or boom. The manager has prepared a regret matrix showing the regret for each of the possible outcomes depending on the decision made.

State of the economy	Regret Matrix			
	Selling price			
	\$40	\$45	\$50	\$55
Boom	\$10,000	\$0	\$20,000	\$30,000
Growth	\$20,000	\$10,000	\$0	\$20,000
Recession	\$0	\$10,000	\$20,000	\$30,000

If the manager applies the minimax regret criterion to make decisions, which selling price would be chosen?

- A. \$40
- B. \$45
- C. \$50
- D. \$55

ANSWER: B

QUESTION NO: 5

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 D F

QUESTION NO: 6

TP makes wedding cakes that are sold to specialist retail outlets which decorate the cakes according to the customers' specific requirements. The standard cost per unit of its most popular cake is as follows:

		\$
Direct material:		
Ingredient A	4 kg at \$25 per kg	100
Ingredient B	3 kg at \$22 per kg	66
Ingredient C	2 kg at \$11.50 per kg	23
Direct labour	3 hours at \$12 per hour	36
Variable overhead	3 hours at \$8 per hour	<u>24</u>
Standard cost		<u>249</u>

The budgeted production for the period was 10,000 units.

Actual results for the period were as follows:

Production (units)		9,000
		\$
Direct material:		
Ingredient A	35,000 kg	910,000
Ingredient B	28,000 kg	630,000
Ingredient C	27,000 kg	296,000
Direct labour	30,000 hours	385,000
Variable overhead		230,000

The general market prices at the time of purchase for Ingredient A and Ingredient B were \$23 per kg and \$20 per kg respectively. TP operates a JIT purchasing system for ingredients and a JIT production system; therefore, there was no inventory during the period.

What was the material yield variance?

- A. The material yield variance was \$98 500 A
- B. The material yield variance was \$175 500 A
- C. The material yield variance was \$155 000 A
- D. The material yield variance was \$175 000 A
- E. The material yield variance was \$155 500 A

ANSWER: D

QUESTION NO: 7

Assume that you have made profit calculations based on standard profit calculation methods and activity based costing methods. In which ways will this information be beneficial to the management team?

Select all the true statements.

- A. Under an activity based costing system the various support activities that are involved in the process of making products or providing services are identified.
- B. The cost drivers that cause a change to the cost of activities are also identified and used as the basis to attach activity costs to a particular product or service.
- C. Through the tracing of costs to product in this way ABC establishes less accurate costs for the product or service.
- D. The identification of cost drivers provides information to management to enable them to take actions to improve the overall profitability of the company.

E. Operational analysis will provide information to management on how costs can be incurred and managed.

ANSWER: A B D

QUESTION NO: 8

RS is a travel company providing daily tours of a major European capital city. The market is highly competitive and RS has commissioned some market research to help with the pricing decision for a new tour. The research identified the probability of three possible market conditions and the number of tickets that would be sold each day at three different price levels.

		Ticket Price		
		\$80	\$90	\$100
Market	Probability	No. of tickets	No. of tickets	No. of tickets
Weak	0.3	80	60	30
Good	0.5	100	90	80
Excellent	0.2	150	150	120

Demonstrate, using a decision tree and based on expected value, which ticket price RS should choose.

- A. RS should charge a ticket price of \$70.
- B. RS should charge a ticket price of \$80.
- C. RS should charge a ticket price of \$90.
- D. RS should charge a ticket price of \$100.
- E. RS should charge a ticket price of \$75

ANSWER: C

QUESTION NO: 9

RT produces two products from different quantities of the same resources using a just-in-time (JIT) production system. The selling price and resource requirements of each of the products are shown below:

Product	R	T
Unit selling price (\$)	130	160
Resources per unit:		
Direct labour (\$8 per hour)	3 hours	5 hours
Material A (\$3 per kg)	5 kgs	4 kgs
Material B (\$7 per litre)	2 litres	1 litre
Machine hours (\$10 per hour)	3 hours	4 hours

Market research shows that the maximum demand for products R and T during June 2010 is 500 units and 800 units respectively. This does not include an order that RT has agreed with a commercial customer for the supply of 250 units of R and 350 units of T at selling prices of \$100 and \$135 per unit respectively. Although the customer will accept part of the

order, failure by RT to deliver the order in full by the end of June will cause RT to incur a \$10,000 financial penalty. At a recent meeting of the purchasing and production managers to discuss the production plans of RT for June, the following resource restrictions for June were identified:

Direct labour hours 7,500 hours

Material A 8,500 kgs

Material B 3,000 litres

Machine hours 7,500 hours

(Refer to previous 2 questions.)

You have now presented your optimum production plan to the purchasing and production managers of RT. During your presentation it became clear that the predicted resource restrictions were rather optimistic. In fact, the managers agreed that the availability of all of the resources could be as much as 10% lower than their original predictions.

Assuming that RT completes the order with the commercial customer, and using linear programming, show the optimum production plan for RT for June 2010 on the basis that the availability of all resources is 10% lower than originally predicted.

- A. The optimal plan is to produce 550 units of Product R and 650 units of product T in addition to the contract.
- B. The optimal plan is to produce 520 units of Product R and 620 units of product T in addition to the contract.
- C. The optimal plan is to produce 510 units of Product R and 720 units of product T in addition to the contract.
- D. The optimal plan is to produce 560 units of Product R and 670 units of product T in addition to the contract.
- E. The optimal plan is to produce 450 units of Product R and 690 units of product T in addition to the contract.
- F. The optimal plan is to produce 500 units of Product R and 550 units of product T in addition to the contract.

ANSWER: F

QUESTION NO: 10

CDF is a manufacturing company within the DF group. CDF has been asked to provide a quotation for a contract for a new customer and is aware that this could lead to further orders. As a consequence, CDF will produce the quotation by using relevant costing instead of its usual method of full cost plus pricing. The following information has been obtained in relation to the contract: Material D 40 tons of material D would be required. This material is in regular use by CDF and has a current purchase price of \$38 per ton. Currently, there are 5 tons in inventory which cost \$35 per ton. The resale value of the material in inventory is \$24 per ton.

Components 4,000 components would be required. These could be bought externally for \$15 each or alternatively they could be supplied by RDF, another company within the DF manufacturing group. The variable cost of the component if it were manufactured by RDF would be \$8 per unit, and RDF adds 30% to its variable cost to contribute to its fixed costs plus a further 20% to this total cost in order to set its internal transfer price. RDF has sufficient capacity to produce 2,500 components without affecting its ability to satisfy its own external customers. However, in order to make the extra 1,500 components required by CDF, RDF would have to forgo other external sales of \$50,000 which have a contribution to sales ratio of 40%.

Labour hours 850 direct labour hours would be required. All direct labour within CDF is paid on an hourly basis with no guaranteed wage agreement. The grade of labour required is currently paid \$10 per hour, but department W is already working at 100% capacity. Possible ways of overcoming this problem are:

- Use workers in department Z, because it has sufficient capacity. These workers are paid \$15 per hour.
- Arrange for sub-contract workers to undertake some of the other work that is performed in department W. The sub-contract workers would cost \$13 per hour.

Specialist machine The contract would require a specialist machine. The machine could be hired for \$15,000 or it could be bought for \$50,000. At the end of the contract if the machine were bought, it could be sold for \$30,000. Alternatively, it could be modified at a cost of \$5,000 and then used on other contracts instead of buying another essential machine that would cost \$45,000. The operating costs of the machine are payable by CDF whether it hires or buys the machine. These costs would total \$12,000 in respect of the new contract.

Supervisor The contract would be supervised by an existing manager who is paid an annual salary of \$50,000 and has sufficient capacity to carry out this supervision. The manager would receive a bonus of \$500 for the additional work.

Development time 15 hours of development time at a cost of \$3,000 have already been worked in determining the resource requirements of the contract.

Fixed overhead absorption rate CDF uses an absorption rate of \$20 per direct labour hour to recover its general fixed overhead costs. This includes \$5 per hour for depreciation.

Calculate the relevant cost of the contract to CDF. You must present your answer in a schedule that clearly shows the relevant cost value for each of the items identified above. You should also explain each relevant cost value you have included in your schedule and why any values you have excluded are not relevant.

Ignore taxation and the time value of money.

Select all the true statements.

- A.** Machine operating costs is a relevant cost.
- B.** Development Cost is a relevant cost.
- C.** General fixed overhead costs are relevant costs.
- D.** Direct labour cost is a relevant cost
- E.** The total relevant cost was \$84 990
- F.** The total relevant cost was \$94 740
- G.** The total relevant cost was \$104 320

ANSWER: A D E