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Level 3 Accounting, 2016

91408 Demonstrate understanding of management accounting to inform decision-making

2.00 p.m. Friday 18 November 2016
Credits: Four

Achievement	Achievement with Merit	Achievement with Excellence
Demonstrate understanding of management accounting to inform decision-making.	Demonstrate in-depth understanding of management accounting to inform decision-making.	Demonstrate comprehensive understanding of management accounting to inform decision-making.

Check that the National Student Number (NSN) on your admission slip is the same as the number at the top of this page.

Pull out Resource Booklet 91408R from the centre of this booklet.

You should attempt ALL the questions in this booklet.

If you need more room for any answer, use the extra space provided at the back of this booklet.

Check that this booklet has pages 2–14 in the correct order and that none of these pages is blank.

YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.

Merit

TOTAL 15

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Notes:
- Ignore GST for all calculations.
- For any required calculations, you must provide detailed and labelled workings. Labelled workings may be assessed.
- Refer to the information provided in **Resource Booklet 91408R** to answer all questions.

QUESTION ONE

(a) Define the cost concept "relevant range", and explain a factor that will limit the relevant range for *Te Kete Mātauranga Crafts* (*TKMC*).
Note: You are NOT required to calculate relevant range.

The relevant range is the level of possible output (flax basket production), given TKMC's current resources. This means is the range in which variable costs will not change over the range of output, and anything (exceeding) beyond this range will require an increase in variable costs. For example if TKMC have a limited number of experienced weavers, production/output of flax baskets is limited to the relevant range possible with the number of weavers.

(b) If selling price is $70 per unit per kete, variable costs are $35 per kete, and fixed costs are $11 340 per annum, calculate the contribution margin for each kete.

contribution margin = selling price − variable costs
= $70 − $35

Contribution margin: $35 (per kete)

(c) Awhina and Pita want to produce a profit of $14 000 in *TKMC*'s first year of operation. Calculate how many kete they would need to sell to achieve this profit target.

$$\text{Profit target} = \frac{\text{fixed costs} + \text{profit target}}{\text{contribution margin}}$$

$$= \frac{14000 + 11340}{35}$$

Targeted kete production to achieve profit of $14 000: 724

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(d) (i) Calculate the margin of safety in terms of the number of kete (assuming that *TKMC* has achieved the targeted kete production from (c) on the previous page.)

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Margin of safety = $\frac{\text{total sales}}{\text{breakeven sales}}$

$= 724 - 324$

breakeven = $\frac{\text{fixed costs}}{\text{contribution margin}}$ $= \frac{11340}{35} = 324$

Margin of safety: 400 number of kete

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(ii) Explain the concept of "margin of safety", and apply this to Awhina and Pita limiting their student loans.

Margin of safety is the margin that Awhina and Pita can lose/gain while still breaking even. If the reach their profit target of \$14 000, selling 724 kete, their margin of safety is 400 kete (meaning the can lose 400 sales and still break even). Any sales made above the break even point (324 kete sales) is profit for Awhina and Pita and can go towards limiting their student loans. Their profit ~~target~~ of \$14000 means they will have an allowance for loss of sales of 400 kete before they go below breakeven (make a loss). This is a positive margin of safety for TKMC and will help limit their student loans. //

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(e) Justify the importance to Awhina and Pita of preparing and regularly updating a production budget for *TKMC*.

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It is important for Awhina and Pita to prepare and regularly update a production budget for TKMC in order to plan/estimate potential output/production based on their current resources.

Without a well-updated production budget, TKMC may not be able to meet customer demand for kete as their estimates for production may be too far off actual production for TKMC.

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QUESTION TWO

(a) Complete the Cash Budget below for *TKMC* showing the receipts and payments for October, November, and December 2016.

TKMC
Cash Budget

	October	November	December	
Receipts				
Grant from iwi	2000	0	0	
Cash sales	700	2 450	4 200	CCC
Cash from accounts receivable	~~[illegible]~~	630 ~~[illegible]~~	1260 ~~[illegible]~~	CC
TOTAL RECEIPTS	2 700	3 080	5 460	
Less payments				
Cellphone costs	55	55	55	V
Other fixed operating expenses	275	275	275	V
Storage rental to marae committee	100	100	100	C
Vehicle expenses	140	140	140	V
Vehicle loan	1 000	1 000	1 000	
Wages to weavers	600	1 650	2 400	
Other variable costs	100	275	400	CC
TOTAL PAYMENTS	2 270	3 495	4 370	
Surplus (~~deficit~~) of cash	430	(415)	1 090	
Opening bank balance	250	680	265	
Closing bank balance and available to cover university costs	680	265	1 355	CP

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(b) Justify whether the Cash Budget you completed on page 6 indicates that *TKMC* will help Awhina and Pita limit their student loan debt.

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Include in your answer:

- specific examples from the cash budget to support your explanation as to whether *TKMC* will help to limit the student loan debt
- an explanation of why Awhina and Pita need to understand that *TKMC*'s cash budget is estimating monthly kete sales.

From the evidence in the cash budget showing the estimated cash inflow and outflow for the first 3 months of operations, their hopes of ~~gaining profit~~ using TMKC to help limit their student loan debt is looking very promising. At then end of each of the 3 months is a forecasted cash surplus (October $680, November $165, and December $1355) which gives Awnia and Pita a total ~~of $2300~~ closing bank balance at the end of the first 3 months of $1355 to be available to cover university costs and pay off/limit their student loan debt. Awnina and Pita do, however, need to undestand that TKMC's cash budget is only estimating monthly kete sales, because the first few months may not necessarily be as successful as planned due to people not knowing about TKMC etc. I do believe, however, that the estimates are quite realistic, with only 20 kete sales in the 1st month, 55 in the second and growing to 80 in the 3rd - so they have obviously taken into account these factors.

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The following Planning Template is provided for you to use to develop ideas for your report.

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Recommendation: Awhina and Pita should set up a mobile-friendly website to expand their business - TKMC.

Financial considerations	Non-financial considerations
↑ costs: Fixed costs will increase due to website expense $30/month = $360/year Fixed costs = $11 700/year Variable costs increase to $40 (+$5 for delivery bags) + increased wages if more staff are needed May need to ↑ rent of shed for more space Going by first 3 months, if the next year follows same trend TKMC will be very profitable.	kete are increasingly popular with both tourists and locals Experienced staff could easily pass on knowledge/training. shed storage may run out more staff may be needed location: access to flax for free (+agreement w council)

I recommend that Awhina and Pita should expand TKMC by setting up a mobile-friendly website enabling customers to order and pay online, if TKMC is successful ~~after~~ in paying off their student loan debt after the first year of university. This is a strategic business decision that will ~~[illegible]~~ impact the business in the future, so it is important that Awhina and Pita consider both financial and non-financial ~~factors to justify~~ information to inform their decision-making. ~~The difference and importance between~~ Both non-financial and financial information is important in the informing of decision-making as non-financial information informs us on things such as consumer preferences (popularity of a product), location, skills etc.

R

More answer space is available on the next page

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that will affect the outcome of the decision in a non-financial manner. Financial information is also very important to consider as it gives indications as to whether the business will be able to sustain the impacts of the decision.

There are numerous reasons that I recommend Awhina and Pita expand their business TKMC if it is successful in paying off their student loans in the first year of university. The first reason is the increase in sales that will come about due to the mobile-friendly website allowing customers to buy online. Since the kete are becoming increasingly popular with tourists and locals, (there is ~~high~~ increasing demand for the kete - flax baskets), the website will make it easier and more convenient for people who are interested in kete to make a purchase.
Awhina and Pita will need to take into account increasing costs that will come about with the ~~bus~~ expansion of TKMC, but I dont think this should turn them away from making the decision to expand, I will explain why:

- Fixed costs will increase to \$11700 per yr due to the website expense (\$30/month = \$360 per year + (current fixed costs \$11340 = \$11700), and variable costs will increase by \$5 for post bags, and if more (50%) staff are hired, an increase in wages of \$10 per kete would make variable costs \$50. This would ~~This sounds bad but the breakeven would~~

hello. **Extra space if required.**
Write the question number(s) if applicable.

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QUESTION NUMBER

3 make the breakeven 585 kete sales, however this is still less than the projected sales of 724 kete baskets ($14000 profit) and TKMC would still have a positive margin of safety of ~~$~~139 (number of kete)

Based on the budgetted cashflow for December, if TKMC continued at that same selling rate for the first year, receipts would be $5460 and payments would be $4570 (no vehicle loan repayment (paid off), plus an increase in variable costs) which still leaves the closing balance with a cash surplus of $890 - without even accounting for the increase in sales that will come about due to the mobile-friendly website enabling customers to purchase kete online.

Having factored in a 50% increase in the number of staff, the increased fixed costs ~~and~~ due to website expenses, AND increased variable costs due to post bags of $5, I can still recommend that Awhina and Pita should expand their business (TKMC) by setting up the mobile friendly website. This is because the financial considerations, will be far outweighed by the ~~increase~~ non financial considerations - keeping up with

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Extra space if required.
Write the question number(s) if applicable.

QUESTION NUMBER

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technology, making their product more readily available to customers and delivering further afeild - all which will contribute to increased sales for TKMC.

Go for it Awhiaia and Pita ☺

Merit exemplar 2016

Subject:	ACCOUNTING	Standard:	91408	Total score:	15

Q	Grade score	Annotation
1	6	The defined relevant range and explained a factor that limited relevant range All three calculations were correct. Margin of safety was explained and linked to the limiting of the student loan. Some aspects of a production budget purpose was applied.
2	5	12 correct entries in the cash budget. A specific example given to limiting the student loan debt.
3	4	A recommendation was made in context. Two examples were given to show an understanding of financial information.