



The Institute of Chartered Accountants of India

Code: FN5SC566609
Subject : Strategic Cost Management and Performance Evaluation

Total Marks: 100
Marks Obtained : 57

Number of Answer Books used : Main + 3 additional sheets

For use by ICAI only

566609



~~25 NOV 2020~~

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| Q.No. | To be ticked (✓) by the candidate against the Questions answered | Marks Awarded (To be filled by Examiner) | | | | | Total |
|-------|--|--|---|---|---|---|-------|
| | | a | b | c | d | e | |
| 1 | ✓ | | | | | | |
| 2 | ✓ | | | | | | |
| 3 | ✓ | | | | | | |
| 4 | ✓ | | | | | | |
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| Total | | | | | | | |

Use only Blue / Black Ball Point Pen to write and shade the circles.
AVOID RED PEN.
 Write the marks in the boxes before shading the respective circles.

Total Marks awarded

| | |
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| 0 | 0 |
| 1 | 1 |
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| 9 | 9 |

Total Marks awarded (in words) _____

Examiner's Signature _____



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INSTRUCTIONS TO THE CANDIDATE

Answers are not to be written on this page

- Answers should be written in figures and words in the allotted space at the and corner of the answer book only and nowhere else including additional answer book/s and graph paper.
- Roll number should be written in the box in numbers and darken the appropriate circles of the OMR bubbles provided in the right hand corner of the cover page with **Black / Blue** ball point pen.
- Fill particulars such as name of Examination, Group No., Paper No. and subject at the appropriate space at the left hand upper corner.
- Remove the Bar Code sticker of the particular paper from the Attendance sheet and affix the same on the box provided in the right hand corner of the cover page.
 - Since a machine will read the Roll no., please check and ensure that Roll number written in numbers, words and circles darkened are correct. In case any candidate fills this information wrongly, Institute will not take any responsibility for rectifying the mistake.
 - The answers should be written neatly and legibly
 - The answer to each question must be commenced on a fresh page and question number prominently written at the top of each answer. Alternatively, the question number should be distinctly written in the margin.
 - The answer to each question in all parts should be fully completed in one page or in a consecutive set of pages, before the next question is taken up.
 - Writing of Roll number in place/s other than the space provided for the purpose or writing distinguishing mark, symbols like "OM", "Sri", "Jesus", "786", etc., will tantamount to adoption of "unfair means"
 - Before submission of answer book to the invigilator take care to score out (X) blank pages, if any, that you might have left.



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Q.3

(Calculation of EVA for JDSL for three years 2019-20.)

WACC :

1 Step 4 $15\% \times 0.3 + 5\% \times 0.7$
 $= 8\%$

Opening Capital Employed.
 (as per audited accounts).

| | |
|--|-------|
| Closing of 2018-19 | 1940 |
| + Non cash exp for 2018-19. | 11 |
| + Bal of the Prov. for doubtful debts. (12-6) | 6 |
| Capital Employed for year 2019-20. | 1957. |

2 Step 3




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Q.3)

| | |
|--|--------|
| Net operating Profit after Tax. (NOPAT). | |
| Operating profit (19-20). | 176. |
| + Depreciation (Acc.) | 124 |
| + R&D | 6 |
| + R&D cost | 20 |
| + Other Non cash items. | 22. |
| - Economic Depreciation. | (156) |
| | 192. |
| - Actual Tax Paid. | (23) |
| | 169. |
| - Tax savings on Interest cost. (42 x 30%) | (12.6) |
| | 156.4. |
| Net operating Profit after Tax. | 156.4. |

2 3Step2

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Q.3)

Economic Value added.

$$= \text{NOPAT} - \text{WACC} \times$$

Op. Cap. Employed

$$= 156.4 - 1957 \times 8\%$$

$$= \boxed{(0.16) \text{ times.}}$$

1

3Step1

Notes :

- i) Capital employed should be increased by any Bal. of RDD of the last year as well any increase of NOPAT in last year.
- ii) All non cash expenses should be added Back including R & D costs.
- iii) Only the actual Tax outflow should be reduced from the NOPAT calculation. and no adj for deferred Tax should be done.
- iv). Tax savings forgone on Interest should be reduced.



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Q.3)

ii)

JCOSE is having a negative Economic Value Added which means the company is unable to generate operating profits which meet the capital charge of the capital employed in the company.

This will affect the shareholders negatively as the key performance indicator of generating a positive EVA is not fulfilled.

2 Step 5

The company's operating margin (operating profit) per both the revenue operations combined is 22.08%, whereas water distribution is generating an operating margin of 18.80% which is lower compared to water packing.

- As this is a regulated sector, company does not have any scope for increasing the same.

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iii) (Q.3)

Acceptable ROCE level of water distribution operation.

Operating Profit (ROCE) of water distribution = 110.

Capital employed as required by water regulator (opening) = 1760.

$$\text{ROCE} = \frac{110}{1760} \times 100 = \boxed{6.25\%}$$

which is below the maximum level of 6.5% and hence JCDSC is working within the capital requirement.

3

3Step6



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Q.3)

iv).

EVA is negative for the year 2019-20 as calculated in the above calculations.

The EVA should be improved in future years as it is the basic requirement of the shareholders to generate income in excess of the capital charge.

Points for improvement in EVA for future years:

i) As per the regulatory requirement the water packing operation cannot exceed beyond 35% of the total operation.

Hence the company should further expand the water packing operation to the maximum of 35%. Presently revenue from WPO is 26.6% which can be increased till 35% in the coming years if other conditions are conducive.

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Q.3)

ii) The rationale behind the same is WPO is generating operating margin of 31.13% as against 18.80% generated by WDO. Hence by further increasing the revenue of WPO, overall operating margin can be improved.

iii) Measures should be undertaken to improve the operating margin of WPO so that it contributes to the overall increase. Also, cash generated from WDO operations should be further invested in WPO operations if there are no regulatory restrictions about the same.

iv) Presently company is utilising only 20% of the total operations for WPO which can be further increased ~~to~~ up till 35% so that overall operating margin further improves.

2 3Step8

3Step7

3Step9

3Step10

13 3



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Q. 2

i) Desired return of Investment
 (45L x 30%) 13,50,000

∴ Profit per set = 225.

Present selling price

| Particulars. | ₹. |
|------------------------|------|
| i) Material. | 275. |
| ii) Labour | 172. |
| iii) Machine Assembly. | 200 |
| iv) Machine Setup. | 28 |
| Total cost. | 675 |

+ Profit (as calculated above). 225

Selling price per set 900

% markup of full cost

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3 2Step1

$$\frac{\text{Profit}}{\text{full cost}} \times 100$$

$$= \frac{225}{900} \times 100$$

$$= 25\% \text{ on full cost.}$$

ii)

1 2Step2

Non value added activities are those which do not add value to the end product and none customer want to pay for such activities as they are wasteful expenditures.

Machine setup time of 5000 hours costing ₹ 168,000 is entirely non value added activity.

Also machine assembly represent around 30% of the total cost, which should be aimed to reduced by value analysis or business process reengineering.



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| 12 | |
|------------|---|
| iii) a) | <p>Target selling price. (900 - 10%) 810</p> <p>→ Target Profit. (225) (as same volume and % return is 585 required to be maintained for profit).</p> <p><u>Hence Target cost is ₹585 per set.</u></p> |
| 2Step3 | <p>Revised cost per unit.</p> <p>Existing cost. 675 (-) improvement leading to reducing material (30) cost.</p> <p>+ Additional specification 20 cost. 5</p> <p><u>Revised cost per unit. 650</u></p> |
| 2Step4 | |

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b) 6 2Step5

There is a cost gap of ₹ 65 per set.
 (650 - 585)

which has to be achieved by the company if the required quantity is desired to be sold by it.

Hence reduction of ₹ 65 per set (which represents around 10% of the existing cost) is required to achieve target profit and target selling price.

iv)

Strategies for achieving target cost as calculated above.

i) Direct Material : As there is no difference in the actual and the standard rates, std rates are $\left(\frac{16,50,000}{100,000} \right) = ₹ 16.5 \text{ sq.ft.}$

Any variance is solely attributable



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to the ~~use~~ usage, which comes
 to: $10,000 \text{ sq.ft} \times 16.5$
 $= ₹ 165,000.$

Hence around 10% of the material
 cost $\left(\frac{165,000}{1650,000} \right)$ was incurred

as a result of inefficiency in the
 usage of the material by the
 workers. Reasons for the same
~~to~~ need to be ascertained as
 this is entirely avoidable cost.
 If any particular worker/group
 of them were ~~was~~ incapable
 of using the material as per
 standard set, training should
 be provided to them.

ii) Direct labour: Again, the
 actual and the standard rates
 per hour are same which
 comes to ₹ 25.8 per hour,
 $\left(\frac{10,32,000}{40,000 \text{ hours}} \right)$. The
 inefficiencies of the labour caused

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an additional outlay of
 $(25.8 \times 5000 \text{ hours}) = ₹ 1,29,000$
 which represent around 12.5%
 of the existing cost.
 Here as well reasons for the
 difference in the ~~usage~~ efficiency
 should be evaluated as around
 12.5% excess hours are utilised.
 It may happen that workees are
 not provided adequate training
 or guidance, also, excess hours
 could be attributable to any
 abnormal reason such as idle time,
 breakdown, etc. which should
 be analyzed for further evaluation.

iii) Machine setup is a totally
 non value adding activity and
 hence should be entirely
 eliminated as these do not add
 any value nor to the production
 process nor the final product.
 This could be done by implementing
 Total Quality management (TQM)

4 2Step8



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so that entire 168,000 could be saved.

iv) Machine assembly represent a huge proportion of the total cost - $\frac{12,00,000}{40,50,000}$ around 30%.

This should be aimed to reduced by implementing Total quality management (TQM) or value analysis or Business process reengineering as any significant reduction in the same can help company achieve target cost.

v) Kaizen costing and Lean manufacturing could be implemented for the continuous improvement of the existing process so as to reduce waste of any kinds.

vi) TQM can also be implemented to eliminate waste.

1 2Step6

6 2Step7

9 2

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| | | |
|-----|---|------------|
| | | |
| Q.4 | | |
| a) | | |
| | <u>Relevant revenue</u> | |
| | Saving in employee cost of 3 workers a day. | |
| | (3 workers x ₹ 400 per day | 12,52,800. |
| | x 261 working days a year x 4 years) | |
| | <u>Relevant Costs</u> | |
| | Cost of implementing the system. | 335,000 |
| | Annual maintenance cost. | 240,000 |
| | (₹ 60,000 x 4 years) | |
| | Net Incremental revenue over 4 years. | 677,800 |



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Notes:

i) As 1 worker would still be required hence cost savings of 3 workers is taken.

ii) As the life is 4 years, the entire plan is evaluated for 4 years.

iii) Working days a year.
 (excluding Saturdays and Sundays).

$$= 365 - 52 - 52$$

$$= 261 \text{ days.}$$

Result:

The overall savings will be ₹ 677800 over a period of 4 years.

3 4aStep2

Hence the automated payment mechanism should be implemented.




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after taking into account the relevant non financial considerations, such as:

2 4aStep1

- i) will the system be capable of handling 100 employees per day.
- ii) How will any breakdown in the system be managed.
- iii) Can the system be capable of operating without any human interference, etc.
- iv) Will the employees face any hardship due to the implementation of system.

5 4a

Q. 4

b)

- i) Current Rejection rate = 7%.
 New Rejection rate = 4%.
 Hence drop in rejection rate due to quality control system = 3%.



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Q.4
 b)

Relevant Revenue

| | |
|---|---------|
| Savings in cost. (3000 x 3% x ₹150 per day). | ₹13,500 |
|---|---------|

Relevant Cost

| | |
|--------------------|---------|
| Cost of New System | ₹12,000 |
|--------------------|---------|

| | |
|-------------------------|-------|
| Net Incremental Revenue | ₹1500 |
|-------------------------|-------|

3 4bStep1

Hence the new system should be implemented as it results in savings of ₹1500 per day.

ii) The proposal will be beneficial till the time the savings in cost are equal to the cost of new system, i.e.



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Q.4
b)

Savings in cost = ₹ 12,000

3000 × x% × 150 = ₹ 12,000

x = 2.67%

Hence the system will be beneficial if units 80 are more are rejected each day. (3000 × 2.67%).

Hence upto savings of 4.33% in the current rejection rate or if the rejection rate is upto 2.67%, the proposal will be beneficial.

Verification: Rejection rate is 2%.
 Cost = 9000.

Rejection rate is 4%.
 Cost = 18000.



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Q.4

c).

Installation of additional production capacity by each division.

1

4cStep3

Z will not be able to install any production capacity as it is already operating at 100%.

Y:

Additional units that will be produced = $5000 \times 20\%$
 $= 1000$

Additional cost = 20
 $\times 1000$ units
 $= 20,000$

Additional cost = 9000×2
 $= ₹ 18,000$.

As it results in ^{savings} outflow of ₹ 2000 Y will ~~not~~ install additional capacity.

Hence Maximum production by Y = 5000.

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X: presently operating at 60%
 and hence can install
 additional capacity of 40%.

Additional cost = 9000×4
 = 36,000

Additional contri =
 5000 units.
 ↓
 (5000 to 4, 2500 to 2
 and 7500 to outside).

Balance demand of 6000 of
 Y and Z ~~and 2500~~. (7500 - 12500).
 = ~~5000 units~~. 6000×9
 = ~~54,000~~. 54,000.

Hence X should install additional
 capacity.

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4cStep5



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Transfer price to Y.

$$\begin{aligned} \text{outside cost} &= 30 \\ + \text{inspection charges} &= 2 \\ \hline &= 32 \end{aligned}$$

Maximum that can be paid by Y 32.

Transfer price to Z

$$\begin{aligned} \text{outside cost} &= 30 \\ - \text{excess modification} &= (3) \\ \hline \text{maximum that can be paid by Z} &= 27 \end{aligned}$$

Hence as the transfer price is uniform for both the divisions, it should be set at 27 as Z will not pay anything about ₹27.

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Contribution and Profit for each division.

| Particulars | X | | Y | | Z | |
|-------------------------|--------------|---------|------|--|------|--|
| | To Outsiders | To Y/Z. | | | | |
| Selling price. | 30 | 27 | 83 | | 90 | |
| -) direct material. | (10) | (10) | (25) | | (35) | |
| -) Transfer price of X. | - | - | (27) | | (27) | |
| -) Alteration cost. | - | - | - | | (3) | |
| -) direct labour. | (6) | (6) | (8) | | (10) | |
| -) V.OH ^d | (2) | (2) | (3) | | (4) | |
| Contribution. | 12 | 9 | 20 | | 11 | |
| 4cStep1 units | 7500 | 7500 | 5000 | | 2500 | |



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Statement of Profit for each divisions.

| | X | Y | Z |
|------------------------|----------|----------|--------|
| Total contribution. | 157,500 | 100,000 | 27,500 |
| → Specific fixed cost. | (36,000) | (18,000) | - |
| Profit: | 121,500 | 82,000 | 27,500 |

2 4cStep6

Total Profit for the Company.

| | | |
|---|---------|---------|
| X | 121,500 | |
| Y | 82,000 | |
| Z | 27,500 | 231,000 |

6 4cStep2

X and Y should install idle capacity of 40% and 20% respectively.

0 4cStep4

7 4c

17 Q4

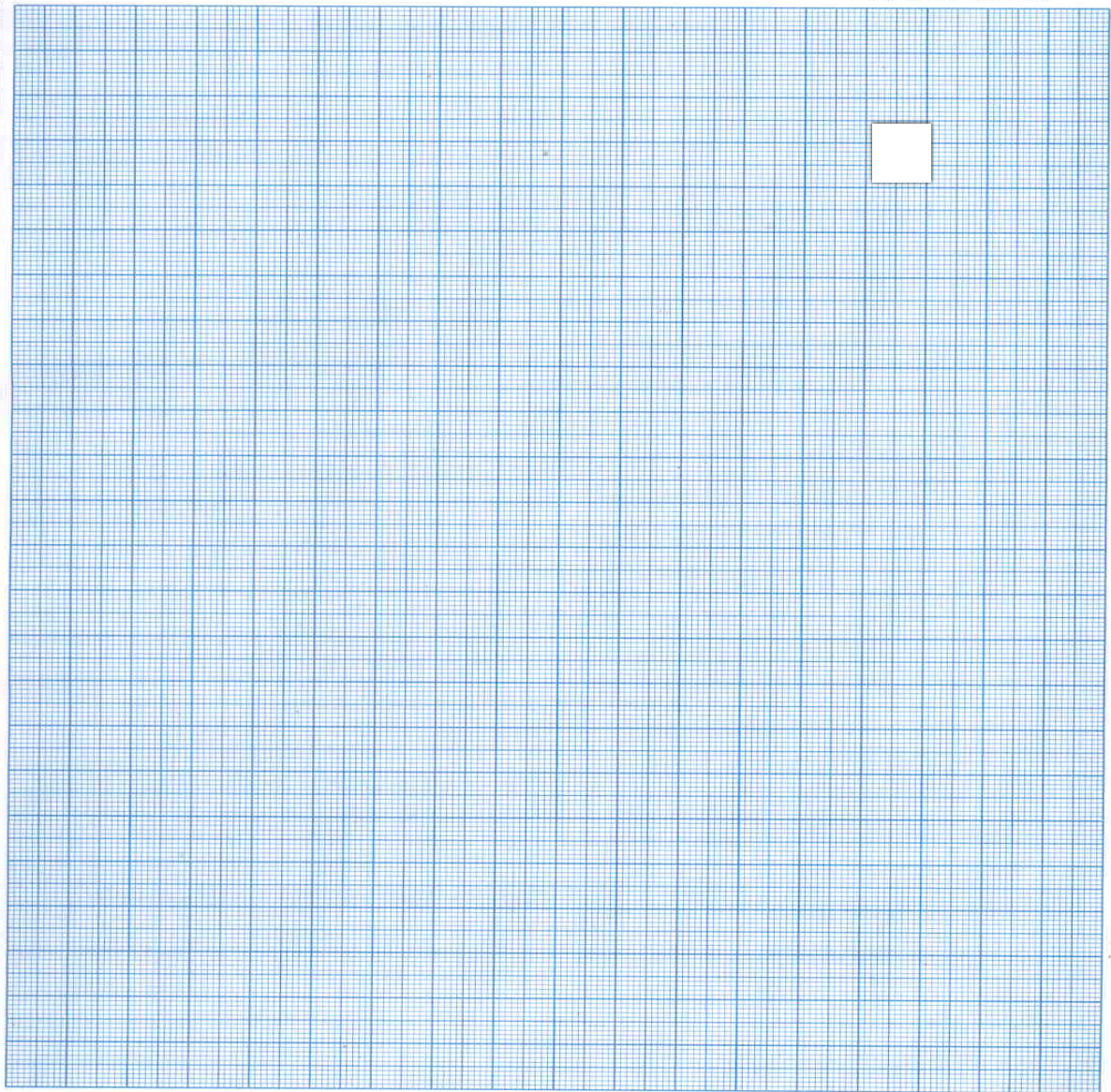


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Q.5

a).

| | | |
|----------------------------------|-----------|-----------------------|
| Manufacturing capacity of plant. | 600 | 900 |
| Plant cost. | 40,00,000 | 56,00,000 (40+40%) |
| Salvage value. | 800,000 | 11,20,000 |

As it is specifically given in the question,
 P/V ratio is assumed to be 30% in both the alternative.
 (Though the variable cost is at variation in each case).

| | | |
|--------------------|--------|--------|
| Selling price. | 45,000 | 41,400 |
| Contribution (30%) | 13,500 | 12,420 |



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Addl. Book No. 1

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 ADDITIONAL ANSWER BOOK

| | | | |
|---|------------------------------|-------------|--------------|
| | Total Contribution. | 81,00,000. | 1,11,78,000 |
| 2 | 5aStep2 (-) Current outflow. | (40,00,000) | (56,00,000). |
| | + Salvage Value. | 800,000 | 11,20,000 |
| 2 | 5aStep3 | 49,00,000 | 66,98,000 |
| 0 | 5aStep4 development cost | (6,50,000) | (6,50,000) |
| | Life cycle profit. | 42,50,000 | 60,48,000 |
| <p>As at 900 units the profit is 60,48,000 hence manufacturing capacity of 900 units should be installed.</p> | | | |



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Extra assumption :

However, if the P/V ratio of 30% is assumed only in case of 600 units in that case,

| | | |
|--|----------------|----------------|
| Contribution. | 81,00,000 | 92,98,800 |
| | (13,500 x 600) | (10,332 x 900) |
| (If variable cost of 26,100 is kept constant). | | |
| -> Other cost | (38,50,000) | (51,30,000) |
| | 42,50,000 | 41,68,800 |

In this case, manufacturing capacity of 600 units should be installed.

Conclusion:
 Hence as the manufacturing capacity of plant at 900 units results in highest cash inflow. such capacity should be installed.

2 5aStep1

6 5a

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Q.5 b).

i) Critical Success factor :



5bStep1

'Delivering Highest Quality Tea'

As it is the only aim and goal of the management, delivery highest quality of tea is the most critical success factor for Osaka Tea Co. Other CSF can also be there, but this is the main one.

ii)

a) Management is keen on increasing the sales value by expanding the sales line to the retail customer for which management is intending to reduce the selling price by 5%.

In case of price sensitive market, any reduction in prices is likely to achieve a higher quantity sales.



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2

5bStep4

b) In case of Osaka Ltd also, the reduction in the sales price has resulted in the adverse sales price variance of 24,500 (A), but this has achieved the management's aim of increase the volume as a result of which the volume shows favourable variance of 20,600 F.

c) Management should ensure this is in line with the strategy of the company as even if the volume increases, the reduction in sales price with ~~price~~ other cost remaining constant affects the overall profitability of the company.

d) Purchase price variance is 15,500 (A) which means the cost of the inputs must have increased or actual quantity must have increased to cater to the additional sales volume.

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2

5bStep3

e) Labour efficiency variance is 14,300 (A) which also reflects that Labour must have taken excess time to cater to the overall increase in the value. If such adverse variance is due to any factor other than increase in volume, then they should be analyzed for further control and action.

d) Fixed cost expenditure variance is 11,100 (A) which reflects actual spending of ₹11,100 in excess of the budgeted fixed cost. Reasons attributable to the same can be : increase in working hours, increase in price of overheads, etc.



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h) If the sales volume is increased as a result of overall market conditions, variances can be analyzed by planning and operational variances as well.

g) Management must ensure that if the volume is to be increased by reducing price, then overall profitability can be deteriorated as otherwise volume will not compensate for reduction in price.

1 5bStep5 h) Also competitors may react to the price reduction decision of the management and there can be an overall shift in the demand of the tea.

0 5bStep2

6 5b

12 Q5

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Q.1).

Performance measurement for
 Not for Profit sector.

- i) As the Not for Profit sector have elements of morality attached to it, the performance evaluation of them through financial measures may not be the most suitable way for the performance evaluation of such sector.
- ii) Instead value for money framework can be useful for evaluating the performance of NPO.
 Elements of value for money framework are:

a) Economy : Judging economy involves assessing cost of the resources deployed. It is assessed at whether best resources ~~are~~ were utilised at appropriate quantity, quality and price.



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ii) Efficiency: It is maximising the output for a given level of input or minimizing the ~~output~~ for the input given level of output.

iii) Effectiveness: It deals with the achievement of the desired results by the deployment of the government programme.

Guideliness for evaluating economy, efficiency and effectiveness are:

2

1Step1

i) Economy: Whether the employees of Nagari Nigam collected all the garbage or litter in the garden area of Taj Mahal. Also, has the contractor been selected after evaluating other tenders from other contractors as well. Whether the log checked by the official is correctly verified by them at the end of the day as payment is made against such logs.

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29 NOV 2020



Addl. Book No. (3)

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ADDL. BOOK

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ADDITIONAL ANSWER BOOK

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2

1Step2

Efficiency : Whether the contractor is cleaning the entire area as and when the mobile messaging system sends a signal from the visitor.

Also, if the scrap which is collected by the contractor is handed over back to the government official and the related controls over the same.

Is the payment made to contractor as per the log filed by him.

Whether Nagaur Nigam's employees are ensuring clean up of bins within 12 hours.

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Effectiveness : Whenever the signal is sent through mobile, the contractor or the Nagaur Nigam's workers



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2 1Step3

Ensure clean within 12 hours of the same.

After the clean up are there any litter or garbage left in the area by them or is it disposed of in the manner contracted.

Patrons can also give inputs about whether the overall process of engaging the contractor and workers is providing the desired results.

Whether the clean up area is further checked by the government official before signing the log.

Are the workers deployed by contractor / Nagar Nigam as commensurate with the requirement of the Job of cleaning up.

ii)

Challenges to assessment of effectiveness:

Effectiveness is the achievement of

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1Step4

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the desired level of results or outcomes by the programme undertaken.

This is a subjective matter as whether the desired results are achieved is not evaluated through any performance measure, which is financial.

Also effectiveness help the government to undertake further control actions whether the programme results are as desired and any variance in them will be evaluated accordingly.

But as effectiveness is a non financial measure, it cannot be quantified in monetary terms and assessed.

iii)

Assessment by audit teams for conclusion.

a) whether the logs were properly

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| | | |
|---|--------|---|
| | 4 | |
| 6 | 1Step5 | <p>Verified by the government employees and details as regard cost of manpower, scrap collected, etc. is entered correctly.</p> <p>whether the actions has been taken within 12 hours of the complaint.</p> <p>whether scrap collected has been properly discarded and accounted for.</p> |
| 0 | 1Step6 | <p>whether government's desired objective of keeping the premise clean is being achieved.</p> <p>whether patrons are suggesting measures and are the same implemented by the government</p> |
| 0 | 1Step7 | <p>whether resources deployed by contractor or Nagare nigan are appropriate for achieving objectives.</p> |
| 6 | 1 | <p>Audit team can also verify other measures and then make conclusion on the value for money</p> |

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Result Overview

Awarded Marks: 57

Max Marks:100

NA Not Attempted

O Optional

M Marked

Q1_Compulsory (Score: 6/20)

| Question No | Awarded Marks | Maximum Marks | Status |
|-------------|---------------|---------------|--------|
| 1 | 6 | 20 | M |

Q2_Q6 (Score: 51/80)

| Question No | Awarded Marks | Maximum Marks | Status |
|-------------|---------------|---------------|--------|
| Q4 | 17 | 20 | M |
| 4a | 5 | 5 | M |
| 4b | 5 | 5 | M |
| 4c | 7 | 10 | M |
| Q5 | 12 | 20 | M |
| 5a | 6 | 10 | M |
| 5b | 6 | 10 | M |
| Q6 | 0 | 20 | O |
| 6a | 0 | 10 | O |
| 6b | 0 | 10 | O |
| 2 | 9 | 20 | M |
| 3 | 13 | 20 | M |