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CPA

Advanced Management Accounting

April 2026

Level: Advanced Level

Question 1a

Environmental management accounting

Evaluate THREE ways in which environmental management accounting can support strategic investment appraisal under regulatory uncertainty for the board.

✓ Answer for Question 1a

Ways in Which Environmental Management Accounting (EMA) Can Support Strategic Investment Appraisal Under Regulatory Uncertainty

Environmental Management Accounting (EMA) involves the identification, measurement, analysis, and reporting of environmental costs and benefits to support managerial decision-making. Under conditions of regulatory uncertainty, EMA assists the board in evaluating investments more comprehensively by incorporating environmental and sustainability considerations into strategic decisions.

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1. Identification of Environmental Costs

- EMA helps identify both direct and indirect environmental costs associated with investment projects.
- This ensures that investment appraisals reflect the true economic cost of environmental impacts.

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2. Improved Investment Decision-Making

- By incorporating environmental costs and benefits into appraisal models, EMA enables the board to make more informed investment decisions.
- Projects that appear profitable under traditional analysis may be reassessed once environmental costs are considered.

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3. Assessment of Regulatory Compliance Costs

- EMA estimates future compliance costs arising from environmental regulations, permits, taxes, and reporting requirements.
- This helps management evaluate the financial implications of regulatory changes.

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Level: Advanced Level

Question 1b

Pricing decisions

Kisasa Electronics Ltd. manufactures cameras and video equipment for high-end users. The company uses life cycle costing and target costing principles to produce the world's smallest and lightest camcorder with superior recording capabilities.

The following summary of the information has been presented by the management accountant:

1. Projected life cycle sales volume 3,000 units
2. Target selling price per unit Sh.8,000
3. Target profit margin 30%
4. Projected total cost based on linear regression analysis on product life cycle in present value terms are as follows:

Cost object	Cost behaviour
Research and development costs:	Y = 3,000,000 + 300X
Design phase costs:	Y = 2,500,000 + 250X
Production expenses per unit:	Y = 1,610X
Marketing and advertisement expenses:	Y = 980,000 + 20X
Distribution and delivery overheads	Y = 1,000,000 + 100X
Customer care service costs:	Y = 1,205,000 + 375X

Where: Y - Total actual cost

X - Projected life cycle sales volume in units

Required:

Using target costing approach, compute unit cost gap for the product.

✓ Answer for Question 1b

Step 1: Compute the Target Cost per Unit

Target cost is determined by subtracting the target profit margin from the target selling price.

- **Target Selling Price per unit:** Sh. 8,000
- **Target Profit Margin:** 30% of the selling price

  Target Profit Margin = 30% × Sh. 8,000 = Sh. 2,400

Target Cost per unit = Target Selling Price − Target Profit Margin

Target Cost per unit = Sh. 8,000 − Sh. 2,400 = Sh. 5,600

Step 2: Compute the Projected Life-Cycle Cost

Using the linear regression equations provided, we substitute the projected life-cycle sales volume (X = 3,000 units) into each cost object formula to find the total actual cost (Y).

Cost Object	Cost Behaviour Formula (Y)	Total Cost Calculation (X = 3,000)	Total Cost (Sh.)	Unit Cost (Sh.)
Research & Development	Y = 3,000,000 + 300X	3,000,000 + 300(3,000)	3,900,000	1,300.00
Design Phase	Y = 2,500,000 + 250X	2,500,000 + 250(3,000)	3,250,000	1,083.33
Production Expenses	Y = 1,610X	1,610(3,000)	4,830,000	1,610.00
Marketing & Advertisement	Y = 980,000 + 20X	980,000 + 20(3,000)	1,040,000	346.67
Distribution & Delivery	Y = 1,000,000 + 100X	1,000,000 + 100(3,000)	1,300,000	433.33

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Question 2a

Inventory control decisions

Jaribio Ltd. operates a conventional stock control system based on re-order levels and economic order quantities (EOQ). The various control levels were set originally based on estimates which did not allow for any uncertainty and this has caused difficulties because in practice, lead times, demands and other factors vary.

As part of a review of the system typical stock item, part No. H24, has been studied in detail as follows:

Data for Part No. H 24	
Lead times (Days)	**Probabbility**
15	0.2
20	0.5
25	0.3
Daily demand (Units)	**Probability**
5,000	0.4
7,000	0.6

Additional information:

1. It costs Sh.1,000 to place an order.
2. The holding cost is estimated at Sh.0.025 for storage plus 10% opportunity cost of capital.
3. Each unit is purchased at Sh.2.
4. The re-order level for this part is currently 150,000 units.
5. The company works for 360 days per year.
6. Assume that the demands would apply for the whole of the appropriate lead-time.

Required:

(i) Calculate the level of buffer stock implicit in a re-order level of 150,000 units.

(ii) Calculate the probability of stock-outs.

(iii) Calculate the expected annual stock-outs in units.

(iv) Compute the stock-out costs per unit at which it would be worthwhile raising the re-order level to 175,000 units.

✓ Answer for Question 2a

(i) Buffer Stock Implicit in R = 150,000 units

Mean Lead Time Demand (E[LTD]):
LTD possibilities:

- 15 days, 5k/day → 75k (p=0.08)
- 15 days, 7k/day → 105k (p=0.12)
- 20 days, 5k/day → 100k (p=0.20)
- 20 days, 7k/day → 140k (p=0.30)
- 25 days, 5k/day → 125k (p=0.12)
- 25 days, 7k/day → 175k (p=0.18)

E[LTD] = 75k×0.08 + 105k×0.12 + 100k×0.20 + 140k×0.30 + 125k×0.12 + 175k×0.18
= 6,000 + 12,600 + 20,000 + 42,000 + 15,000 + 31,500 = **127,100**

Buffer Stock = R - E[LTD] = 150,000 - 127,100 = **22,900 units**

(ii) Probability of Stock-outs

Stock-out occurs when LTD > 150,000:

Only LTD = 175,000 (p=0.18) qualifies.

$P(\text{stock-out}) = 0.18$

(iii) Expected Annual Stock-outs in Units

Expected shortage per cycle E[S]:

Shortfall = 175,000 - 150,000 = 25,000 units

E[S] = 25,000 × 0.18 = **4,500 units/cycle**

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Level: Advanced Level

Question 2a

Inventory control decisions

Discuss FOUR salient features of just-in-time (JIT) inventory system.

✓ Answer for Question 2a

Salient Features of the Just-In-Time (JIT) Inventory System

The Just-In-Time (JIT) system is a management philosophy aimed at eliminating waste by producing or acquiring goods only as they are needed. Its salient features represent a fundamental shift from traditional "just-in-case" inventory management.

1. Pull-Based Production (Kanban System)

Unlike traditional push systems that produce based on forecasts, JIT operates on a **pull system**. Production is triggered by actual customer demand. A visual signal, often a **Kanban card**, is used to authorize the movement or production of materials. This ensures that nothing is made without a downstream demand, drastically reducing work-in-progress (WIP) inventory.

2. Low or Zero Inventory Levels

JIT seeks to minimize inventory holding costs (storage, insurance, capital tied up) by aiming for **zero inventory**. Raw materials arrive just before production, components are made just before assembly, and finished goods are completed just in time for shipment. This exposes hidden problems like machine breakdowns or quality issues that were previously buffered by high inventory.

3. Emphasis on Quality at the Source (Jidoka)

JIT requires a **"do it right the first time"** approach. The concept of **Jidoka** (autonomation) empowers any worker to stop the production line (*Andon cord*) when a defect is found. The goal is to identify and correct the root cause of quality issues immediately, preventing the production of defective units and the waste they represent.

4. Close and Collaborative Supplier Relationships

JIT necessitates a small, highly reliable supplier base. Instead of adversarial, price-focused relationships, JIT fosters **long-term partnerships** with suppliers

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Question 2b

Strategic management accounting information

With reference to international transfer pricing, explain the meaning of the following transfer pricing methods:

(i) The “comparable uncontrolled price” method.

(ii) The “resale price” method.

✓ Answer for Question 2b

International Transfer Pricing Methods

International transfer pricing refers to the rules and methods for pricing transactions between enterprises under common ownership or control across international borders. Tax authorities (like the Kenya Revenue Authority) use these methods to ensure that profits are not artificially shifted to low-tax jurisdictions, a practice known as **profit shifting**. The goal is to determine an **Arm's Length Price**—the price that would have been charged if the two entities were independent, unrelated parties.

(i) Comparable Uncontrolled Price (CUP) Method

- **Meaning:** This is the most direct and preferred method. It compares the price charged for goods or services transferred in a **controlled transaction** (between related parties, e.g., a parent company and its foreign subsidiary) to the price charged in a **comparable uncontrolled transaction** (between two independent, unrelated parties).
- **Application:** For the CUP method to be reliable, the controlled and uncontrolled transactions must be very similar. The comparability is assessed based on:
  - **Product Characteristics:** The physical nature, quality, and quantity of the goods or services.
  - **Contractual Terms:** Payment terms, delivery terms (e.g., FOB, CIF), and warranties.
  - **Market Conditions:** The geographic market, level of the market (e.g., wholesale, retail), and the timing of the transaction.
- **Example:** If Company A in Kenya sells a specific chemical to its subsidiary, Company B in Uganda, for Sh. 500 per litre, the CUP method would check if Company A sells the same chemical to an independent distributor in Tanzania for Sh. 500 per litre under similar terms. If it does, the price is at arm's length.

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Question 3a

Inventory control decisions

Rahisi Supermarket uses different ordering policies to acquire its inventory. Due to uncertainty of supply of product “X”, the management accountant is evaluating the optimal order size for this product to set for the coming year 2025.

The relevant data on the ordering policy is provided as follows:

Order policy	Units of product “X” ordered
Order twice monthly	500 units per order
Order monthly	1,000 units per order
Order quarterly	3,000 units per order
Order semi-annually	6,000 units per order
Order annually	12,000 units per order

Additional information:

1. It is ascertained that the purchase price per unit of product “X” is Sh.500 for deliveries up to 2,500 units.
2. A 5% discount is offered by the supplier of product “X” on the whole order where deliveries are 2,501 up to 5,000 units.
3. A 10% discount on total order for deliveries in excess of 5,000 units is guaranteed.
4. Each purchase order incurs fixed requisition costs of Sh.1,200 per order.
5. The carrying cost is Sh.20 per unit per year plus 12% opportunity cost of the purchase price.
6. The purchasing lead time is 3 weeks. Rahisi Supermarket is open 48 weeks per annum. Each year has 12 months.

Required:

(i) Economic order quantity (EOQ) for product “X”.

(ii) Advise the management of Rahisi Supermarket on the optimum order size of product “X”.

(iii) The optimal reorder level of product “X”.

✓ Answer for Question 3a

Given Data:

- Annual demand, $D = 12,000$ units
- Ordering cost per order, $S = \text{Sh. } 1,200$
- Carrying cost per unit per year, $H = \text{Sh. } 20 + 12\%$ of purchase price
- Purchase price per unit:
  - $P = \text{Sh. } 500$ for $Q \leq 2,500$
  - $P = \text{Sh. } 475$ for $2,501 \leq Q \leq 5,000$
  - $P = \text{Sh. } 450$ for $Q > 5,000$
- Lead time = 3 weeks
- Operating weeks per year = 48

(i) Economic Order Quantity (EOQ)

$$\text{EOQ} = \sqrt{\frac{2DS}{H}}$$

Calculation:

- $H = 20 + 0.12 \times 500 = 20 + 60 = \text{Sh. } 80$
- $EOQ = \sqrt{\frac{2 \times 12,000 \times 1,200}{80}} = \sqrt{360,000} = 600 \text{ units}$

EOQ = 600 units

(ii) Optimum Order Size

Total Cost Formula:

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Question 3b

Planning and decision making techniques

Solamax Ltd. makes small assembled solar panels for the domestic local market. The marketing manager believes that in the short run their sales can improve by launching a massive marketing campaign strategy.

The following marketing strategies have been proposed based on the demand for the product:

Strategy A:	Advertise locally
Strategy B:	Online marketing
Strategy C:	Mass media advertisement with the local television media house

The company uses expected value to make this type of decision. The estimated annual profit or (loss) under the three states of market reaction for each market strategy is as follows:

	Market reaction (Demand)		
Marketing strategy	**High Sh.“000”**	**Medium Sh.“000”**	**Low Sh.“000”**
Market locally	1,300,000	500,000	350,000
Online marketing	1,500,000	850,000	410,000
Mass media advertisement	1,700,000	905,000	(105,000)

Additional information:

1. Strategy A has low fixed costs and high variable costs; strategy B has average fixed costs and average variable costs while strategy C has high fixed costs and low variable costs.
2. There is a 30% chance that demand will be high, a 40% chance that demand will be medium and a 30% chance that demand will be low.
3. A market research company believes it can provide perfect information at a cost of Sh.100,000,000.

Required:

(i) Calculate the maximum amount payable to acquire perfect information.

(ii) Advise the management of Solamax Ltd. whether it is viable to acquire the perfect information from the market research company.

✓ Answer for Question 3b

(i) Maximum Amount Payable for Perfect Information

The expected value without perfect information is calculated for each strategy:

- **Strategy A (Market locally):**
  EV_A = (0.3 × 1,300,000) + (0.4 × 500,000) + (0.3 × 350,000) = 695,000 (in Sh. '000)
- **Strategy B (Online marketing):**
  EV_B = (0.3 × 1,500,000) + (0.4 × 850,000) + (0.3 × 410,000) = 913,000 (in Sh. '000)
- **Strategy C (Mass media advertisement):**
  EV_C = (0.3 × 1,700,000) + (0.4 × 905,000) + (0.3 × -105,000) = 840,500 (in Sh. '000)

Maximum EV without perfect information: **913,000** (in Sh. '000) from Strategy B.

Expected value with perfect information (EVwPI) by selecting the best strategy for each demand state:

- High demand: Strategy C (1,700,000)
- Medium demand: Strategy C (905,000)
- Low demand: Strategy B (410,000)

EVwPI = (0.3 × 1,700,000) + (0.4 × 905,000) + (0.3 × 410,000) = 995,000 (in Sh. '000)

EVPI = EVwPI - $EV_{without_{PI}}$ = 995,000 - 913,000 = 82,000 (in Sh. '000) = **Sh. 82,000,000**

(ii) Viability of Acquiring Perfect Information

Cost of perfect information: **Sh. 100,000,000**
Since EVPI (Sh. 82,000,000) < cost (Sh. 100,000,000), it is **not viable** to acquire the perfect information.
Advise: Proceed with Strategy B (Online marketing) without acquiring the perfect information.

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Question 4a

Environmental management accounting

Highlight FOUR roles of a management accountant in accounting for environmental costs.

✓ Answer for Question 4a

Key Roles of a Management Accountant in Accounting for Environmental Costs

Management accountants play a pivotal role in making environmental costs visible, manageable, and strategically relevant. Their primary function is to integrate environmental data into the core decision-making processes of the organization.

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1. Identification and Classification

- **Role:** To identify all costs associated with the environmental impact of the organization's activities. This goes beyond obvious costs like waste disposal.
- **Actions:**
  - Differentiate between **environmental protection costs** (e.g., waste treatment, pollution control) and **environmental prevention costs** (e.g., designing cleaner processes).
  - Classify costs as **direct** (easily traceable, e.g., cost of biodegradable materials) or **indirect** (overhead, e.g., environmental department salaries).

2. Measurement and Allocation

- **Role:** To accurately assign monetary value to environmental costs and allocate them to the appropriate products, services, or processes.
- **Actions:**
  - Use **Activity-Based Costing (ABC)** to trace environmental overhead costs more accurately to the activities that cause them (e.g., allocating emissions control costs to a specific manufacturing line).
  - Quantify "hidden" costs that are often buried in general overhead accounts.

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Question 4

Planning and decision making techniques

Green Coaches Ltd. is an electric-bus assembly company. The company has received a special order from Transland Bus Company to supply 15 executive electric buses for bus rapid transport (BRT) project at a target price of Sh.8 million per bus.

Due to the novelty of the project and challenges of learning curve effect, the company wants to analyse three scenarios available before accepting the special order. These scenarios are:

Scenario 1:
To work overtime and deliver the 15 buses within stipulated period.

Scenario 2:
To complete 14 buses using overtime and deliver 1 bus late.

Scenario 3:
To assemble and deliver the 13 buses without overtime and deliver 2 buses late.

Additional information:
1. The target profit margin is 20% of the target price per bus.
2. The contract allows for 92 working days without overtime for the assembly and delivery of buses and stipulates a penalty of Sh.1.5 million for each bus delivered late.
3. The time taken to complete the first bus is 10 days.
4. Direct labour cost is Sh.180,000 per day for the normal working days per month and overtime premium rate is double the normal rate.
5. Overheads will be allocated to the special order at a rate of Sh.30,000 per normal working day and no overheads will be allocated for overtime working.
6. The management accountant's estimate of direct material cost per bus is Sh.2,500,000.
7. The learning curve index at 90% learning rate is -0.152.
8. The learning curve model is in the form of $Y = ax^{-b}$.

Required:
(a) Evaluating each scenario, advise the management on the most economical scenario using learning curve analysis.

b) Using target costing approach, compute the cost savings of the most economical scenario identified in (a) above.

(c) Explain FOUR non-financial factors that may have a bearing on the decision for the special order by the management of Green Coaches Ltd.

✓ Answer for Question 4

Evaluation of Scenarios for Green Coaches Ltd.

(a) Most Economical Scenario Using Learning Curve Analysis

The learning curve model is $Y = 10 \times X^{-0.152}$, where Y is the time in days for the X-th bus. The cumulative time for producing 15 buses is 113.843 days. The costs for each scenario are evaluated as follows:

- **Scenario 1**: Deliver all 15 buses on time using overtime.
  - Overtime days: $113.843 - 92 = 21.843$ days
  - Labour cost: $(92 \times 180,000) + (21.843 \times 360,000) = 16,560,000 + 7,863,480 = 24,423,480$
  - Overheads: $92 \times 30,000 = 2,760,000$
  - Penalty: 0
  - Total cost: $37,500,000 + 24,423,480 + 2,760,000 = 64,683,480$
- **Scenario 2**: Deliver 14 buses on time using overtime and 1 bus late.
  - Cumulative time for 14 buses: 107.213 days
  - Overtime days: $107.213 - 92 = 15.213$ days
  - Time for 15th bus: $113.843 - 107.213 = 6.63$ days
  - Labour cost: $(92 \times 180,000) + (15.213 \times 360,000) + (6.63 \times 180,000) = 16,560,000 + 5,476,680 + 1,193,400 = 23,230,080$
  - Overheads: $(92 + 6.63) \times 30,000 = 98.63 \times 30,000 = 2,958,900$
  - Penalty: $1 \times 1,500,000 = 1,500,000$
  - Total cost: $37,500,000 + 23,230,080 + 2,958,900 + 1,500,000 = 65,188,980$
- **Scenario 3**: Deliver 11 buses on time without overtime and 4 buses late (since delivering 13 buses on time without overtime is infeasible due to cumulative time of 100.523 days exceeding 92 days).
  - Cumulative time for 11 buses: 86.903 days (within 92 days)
  - Total labour days for 15 buses: 113.843 days
  - Labour cost: $113.843 \times 180,000 = 20,491,740$

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Question 4b

Planning and decision making techniques

Fixit Fabricators Ltd. has been facing a lean financial spell for the past two years. The profit has been declining steadily and the results of the preceding year showed a loss of Sh.2,000,000. This is the first time the company has reported a loss in its 10-year history.

The chairman and the board of directors have been deliberating on the remedial steps to implement to arrest the situation. Three competing proposals have been suggested by a taskforce set up some months back aimed at boosting sales and improving efficiency of operations in the current year. As a member of the taskforce, you have been invited to attend the next board meeting to deliberate on the proposals.

The following information is available:

1. The target profit for the current year is Sh.4,000,000 regardless of the proposal that will be adopted.
2. The company's fixed costs currently amount to Sh.20,000,000 per year.
3. The company can sell up to a maximum of 12,000 units of its product in the local market and unlimited quantities in a neighbouring country. For the sales in the local market, unit variable costs amount to Sh.5,000, while for the sales in the neighbouring country, an extra Sh.500 per unit is incurred in transportation expenses.
4. The same transfer price of Sh.10,000 normally prevails both in the local market and neighbouring country.
5. Sales for the past year amounted to 9,000 units, all in the local market.

The main requirements of the three competing proposals are as follows:

Proposal A:	The Company should improve the quality of packaging of its products at a cost of Sh.500 per unit.
Proposal B:	The company should spend Sh.2,000,000 on an advertising campaign.
Proposal C:	The Company should reduce the selling price by Sh.500 per unit.

Required:

(i) For proposals A, B, and C, determine the break-even point in the neighbouring country in order to achieve the target profit.

(ii) Summarise FIVE financial factors to consider for proposal C.

✓ Answer for Question 4b

(i) Break-even point in the neighbouring country to achieve the target profit

The break-even point in units is calculated using the formula:

$$\text{Break-even units} = \frac{\text{Fixed costs} + \text{Target profit}}{\text{Contribution per unit in neighbouring country}}$$

Base data:

- Fixed costs (current): Sh. 20,000,000
- Target profit: Sh. 4,000,000
- Selling price in neighbouring country: Sh. 10,000 per unit
- Variable cost in neighbouring country: Sh. 5,000 (local) + Sh. 500 (transport) = Sh. 5,500 per unit
- Normal contribution per unit: Sh. 10,000 – Sh. 5,500 = Sh. 4,500

Proposal A: Improve packaging at Sh. 500 per unit (additional variable cost)

- Contribution per unit: Sh. 10,000 – (Sh. 5,500 + Sh. 500) = Sh. 4,000
- Fixed costs: Sh. 20,000,000 (unchanged)

$$\text{Break-even units} = \frac{20{,}000{,}000 + 4{,}000{,}000}{4{,}000} = \frac{24{,}000{,}000}{4{,}000} = 6{,}000 \text{ units}$$

Proposal B: Advertising campaign costing Sh. 2,000,000 (additional fixed cost)

- Contribution per unit: Sh. 4,500 (unchanged)
- Fixed costs: Sh. 20,000,000 + Sh. 2,000,000 = Sh. 22,000,000

$$\text{Break-even units} = \frac{22{,}000{,}000 + 4{,}000{,}000}{4{,}500} = \frac{26{,}000{,}000}{4{,}500} = 5{,}777.78 \approx 5{,}778 \text{ units}$$

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Question 5a

Planning and decision making techniques

Explain THREE conceptual differences between the following concepts as applied in strategic management for short term decision making:

(i) Throughput accounting.

(ii) Limiting factor analysis.

✓ Answer for Question 5a

Conceptual Differences Between Throughput Accounting and Limiting Factor Analysis

(i) Throughput Accounting (TA)

- **Philosophical Basis:** Part of the Theory of Constraints (TOC); focuses on maximizing the rate at which the system generates money through sales.
- **Cost Perspective:** Only direct materials are considered truly variable costs; all other costs (labor, overheads) are treated as fixed in the short term.
- **Key Metric:** Throughput contribution = Sales revenue – Direct material costs.
- **Objective:** Maximize throughput while minimizing inventory and operating expenses.
- **Decision Focus:** Identify and exploit bottlenecks (constraints) to increase overall system throughput.
- **Short-Term Application:** Prioritize products that generate the highest throughput per unit of bottleneck resource; discourage inventory buildup.

(ii) Limiting Factor Analysis (LFA)

- **Philosophical Basis:** Traditional management accounting approach; focuses on optimal resource allocation when a scarce resource exists.
- **Cost Perspective:** Distinguishes between variable costs (direct materials, direct labor, variable overheads) and fixed costs.
- **Key Metric:** Contribution = Sales revenue – All variable costs.
- **Objective:** Maximize total contribution by allocating the limiting resource to products with the highest contribution per unit of that resource.
- **Decision Focus:** Determine the product mix that maximizes profit given a single or multiple constraints.
- **Short-Term Application:** Use contribution per unit of limiting factor (e.g., machine hours, labor hours) to rank products; may support producing for inventory if it maximizes contribution.

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Question 5b

Budgetary control techniques

Rigid Ltd. prepared fixed and flexible budgets for the financial year 2020/2021 as provided below:

	Fixed budget for full capacity	Flexible budget for 75% level
Sales	1,350,000	1,012,500
Direct materials	425,000	318,750
Direct labour	185,000	138,750
Variable overheads	215,000	161,250
Semi variable overheads	365,000	323,750
Profit	**160.000**	**160.000**

After the closing of the financial year 2020/2021, the total actual sales stood at Sh.1,107,000 and there was a favourable sales price variance of Sh. 27,000.

Required:

Prepare a flexible budget for the actual level of sales.

✓ Answer for Question 5b

Flexible Budget for Actual Level of Sales

Step 1: Determine budgeted sales at actual volume

Actual sales = Sh. 1,107,000

Sales price variance (favourable) = Sh. 27,000

Budgeted sales at actual volume = 1,107,000 – 27,000 = **Sh. 1,080,000**

Step 2: Determine activity level

Full-capacity sales = Sh. 1,350,000

Activity level = 1,080,000 ÷ 1,350,000 = **80%**

Step 3: Compute costs at 80% activity

- **Direct materials:** Variable with sales
  = 80% × 425,000 = **Sh. 340,000**
- **Direct labour:** Variable with sales
  = 80% × 185,000 = **Sh. 148,000**
- **Variable overheads:** Variable with sales
  = 80% × 215,000 = **Sh. 172,000**
- **Semi-variable overheads:**
  Variable cost per 1% capacity = (365,000 – 323,750) ÷ 25 = Sh. 1,650
  Variable portion at 80% = 80 × 1,650 = Sh. 132,000
  Fixed portion = 365,000 – (100 × 1,650) = Sh. 200,000
  Total = 200,000 + 132,000 = **Sh. 332,000**

Step 4: Compute profit

Total costs = 340,000 + 148,000 + 172,000 + 332,000 = Sh. 992,000

Profit = 1,080,000 – 992,000 = **Sh. 88,000**

Flexible Budget at Actual Sales Level

Item	Amount (Sh.)