

STRICTLY CONFIDENTIAL

THE PUBLIC ACCOUNTANTS EXAMINATION
COUNCIL OF MALAWI

2010 EXAMINATIONS

FOUNDATION STAGE

PAPER 4: ORGANISATIONAL FRAMEWORK

WEDNESDAY 8 DECEMBER 2010

TIME ALLOWED : 3 HOURS
2.00PM 5.00PM

SUGGESTED SOLUTIONS

1. (a) (iv)
- (b) (ii)
- (c) (i)
- (d) (iii)
- (e) (iii)
- (f) (iii)
- (g) (ii)
- (h) (i)
- (i) (iii)
- (j) (i)
- (k) (iv)
- (l) (iii)
- (m) (iv)
- (n) (ii)
- (o) (iii)
- (p) (i)
- (q) (iv)
- (r) (ii)
- (s) (iv)
- (t) (iii)

SECTION B

Answer ONE question ONLY from this Section

2. (a) Business firms are important to society because they:
- (i) help in allocating resources which are available.
 - (ii) provide employment.
 - (iii) produce goods and services for the common good.
- (b) In a market oriented economy firms determine what goods to produce. They bid for the resources necessary to produce, control and own capital. A market oriented economy is said to be efficient because allocation of resources and distribution of goods is done through market forces of demand and supply. However some of the problems that may occur and require control in a market-oriented economy are:
1. Resource exploitation

Certain groups or individuals may gain excessive economic power that permits them to obtain too large a share of the value created by firms i.e. monopoly.

To control this society introduces laws to regulate or rationalize industries especially where the product or service has no substitute or requires the use of a national or natural resource.
 2. Competition

Too much competition may lead to over exploitation of resources leading to waste through over production. It also creates problems of dumping. Government may set economic policies to reduce competition e.g. restrict certain categories of producers through interest rates from entering certain industries. The opposite may be where some large scale producers collude to form mergers that restrict competition.

Legislation on monopoly and mergers aims at promoting competition and controlling large scale producers.
 3. Worker Exploitation

Free enterprises have the potential to exploit employees in order to maximize profits.

Labour laws provide for the protection of workers from unfair practices and provide them with bargaining power.

4. Social Costs

Producers who use natural resources or carry out production activities that involve dumping of waste in rivers and lakes, or pollute the air and produce noise are a burden to society.

Society makes laws that require such firms to pay taxes to cover social costs. Government may also pass anti-pollution laws to deter or protect the environment from effects of production.

5. Price regulation

Although prices are determined by market forces in a free enterprise, price variations exist due to many factors such as seasonality of the product, distances from source of production, income variations.

Government may introduce price regulation to standardize prices. It may outlaw price fixing and price wars. It may introduce minimum and maximum price ceilings or subsidize certain products.

3. (a) (i) Demand is the number of units of a good or service which buyers are willing to buy during a particular period under a given set of conditions i.e. a set of variables.
- (ii) A Demand function for a product is a statement that specifies the relationship between the quantity demanded and the factors that determine this quantity i.e. the independent variables such as prices, consumer incomes, population, advertising expenditure etc.

A demand function may thus be written as

$$Q = a_1P + a_2Y + a_3\text{Pop} + a_4C + a_5A \dots\dots\dots$$

Where Q = Quantity demanded

$a_1 \dots\dots\dots$ represents parameters of variables that affect demand

P = Price

Y = Disposable income

Pop = Population

C = Index of credit terms

A = Advertising expenditures

A demand curve is that part of the demand function which expresses the relationship between price charged for a product and the quantity demanded, holding constant the effects of all other independent variables expressed above.

A demand curve is a graph in which all the independent variables are assumed to be constant except price.

(b) (i) Estimation of demand

Demand Function

$$Q = -3000P + 1000Y + 0.05\text{Pop} + 1,500,000C + 0.05A$$

$$Q = (-3000 \times \text{K}3000) + (1000 \times \text{K}2000) + (0.05 \times 20,000,000) + (1,500,000 \times 1) + (0.05 \times \text{K}100,000,000)$$

$$Q = -9,000,000$$

$$2,000,000$$

$$1,000,000$$

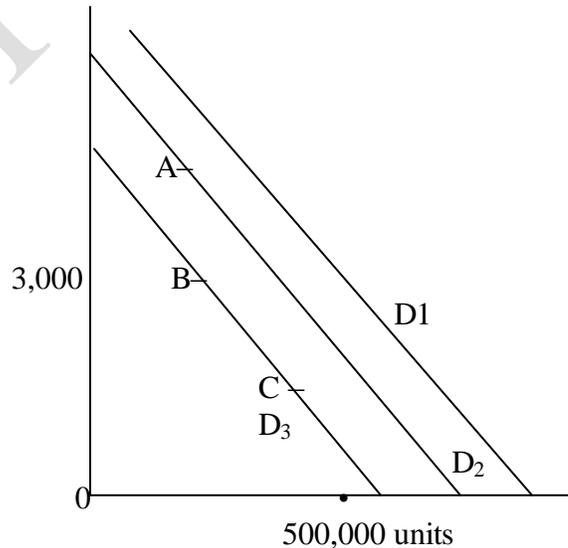
$$1,500,000$$

$$\underline{5,000,000}$$

$$Q = \underline{\underline{500,000}} \text{ units}$$

The parameters indicate that demand for cars will fall by 3000 units for each K1 increase in the average price charged. It will increase by 1000 units, for each increase of K1 increase per capita disposable income: will increase by 0.05 units for each additional person in the population. Demand will increase by 0.05 units for each K1 spent on advertising and increase by 1.5 million units if the index of credit availability increases by 1 unit.

(ii) The Demand Curve



Demand is 500,000 when price is K3,000.

1. Movements along the demand line e.g. from B to C and vice versa represent change in quantity resulting from change in price while the other variables remain constant.
2. Shifting of the demand line from D_1 to D_2 to D_3 and vice versa represents change in demand arising from change in any one or several of the independent variable apart from price.

SECTION C

Answer ONE question ONLY from this Section

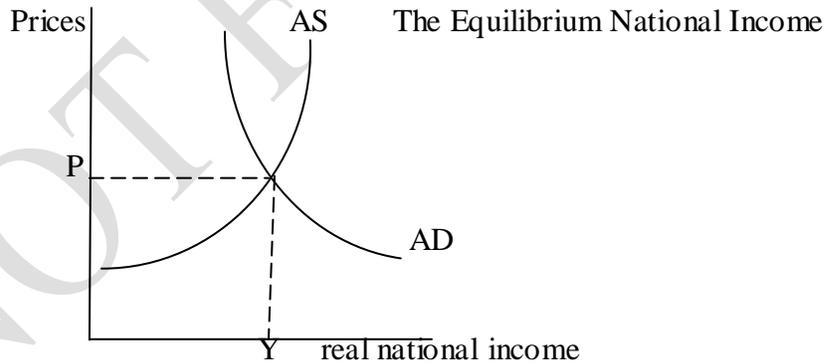
4. (a) National income is the sum of all incomes earned by residents of a particular country through economic activities such as the production of goods and services and employment.

The national income equilibrium is a point where aggregate demand crosses aggregate supply.

Aggregate demand is the total demand for goods and services in an economy whereas

aggregate supply is the total supply of goods and services in the economy.

Output and levels of unemployment and price levels (inflation) are determined by the interaction of aggregate demand and supply of national income.



AS is the aggregate supply

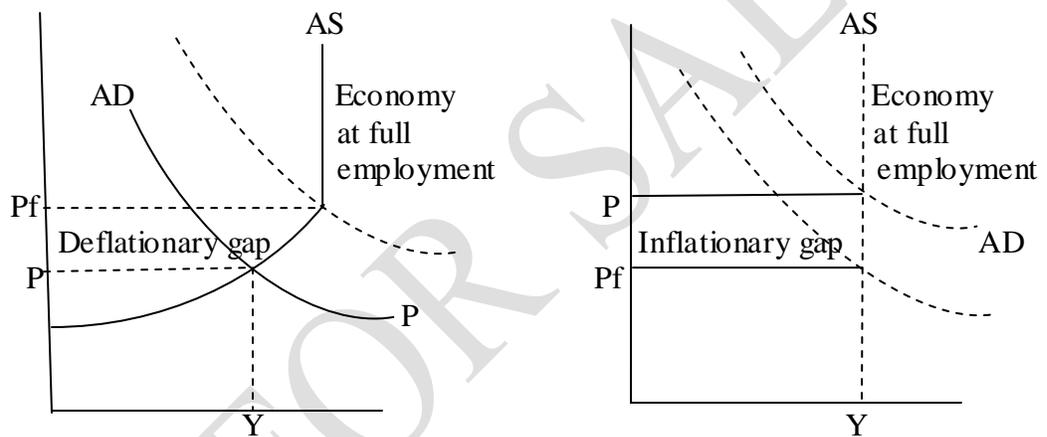
Aggregate supply depends on production conditions such as availability of factors of production including labour and technical knowhow. The AS slopes upwards to the right because suppliers supply more when price is high and less when price is low. There is a positive relationship between output and price in national income. As long as resources are not fully employed, the AS will continue to slope upwards to the right. A level will, however, be reached where the economy's resources will be fully employed i.e. at full employment.

The economy cannot produce more even as prices continue to rise. The AS will at that point rise vertically at Y output.

AD is the aggregate demand.

This is total demand for all goods and services in an economy by consumers. The AD slopes downwards to the right because people desire more of a product as prices go down i.e. there is an inverse relationship between price and output. The actual level of national income will be at the intersection of AS and AD.

- (b) Inflationary gap and deflationary gaps exist in an economy when the aggregate demand curve intersects the aggregate supply curve above or below the ideal equilibrium point shown in the diagram above.



In order to produce the full employment level of national income, the aggregate demand may have to be moved upwards or downwards. When the AD intersects the AS below the full employment level, we say there is a deflationary gap. This is a situation where prices are fairly constant and output changes as aggregate demand changes.

Under inflationary gap, prices rise but real output remains constant. Inflation may therefore be controlled by controlling elements that affect aggregate demand.

5. (a) (i) An exchange rate is a price at which one country's currency can be traded in exchange for another country's currency.
- (ii) Like any price, exchange rates fluctuate i.e. go up or down relative to the product's availability. Every country has a price (an exchange rate for the currency of each country with which it trades). Factors which influence changes in exchange rates include:

- (1) The rate of inflation in the trading countries. An exchange rate varies according to relative price changes.

An increase in prices in country A relative to country B will cause the exchange rate to fall making it cheaper for country A to import from B.

- (2) Interest rates
If country A raises its interest rates relative to country B, country B will find it profitable to invest in country A. That translates into an increase in short-term foreign investment which raises the exchange rate of country A.
- (3) The balance of payments
The balance of payments are composed of current accounts in which are trading goods, investment earnings, foreign assets and liabilities. These are all affected by price changes. If prices in a country fell, the current account values would also fall making exports to other countries cheaper thereby pushing up the exchange rate.
- (4) Government Intervention
Government can buy or sell its own currency on the open market at a price determined by the mechanism of demand and supply.
- (5) Speculation
Speculation about the shortage of a given currency can cause the exchange rate to go up.

- (b) To manage exchange rates a Government may

- (1) Fix the rates
Fixed exchange rates require that the government must use its reserves to regulate deficits and surplus in order to stop the rate from changing.
- (2) Free Floating Exchange rates
Instead of controlling, the exchange rates are left to respond to the market forces of demand and supply on the foreign exchange market.

- (2) Movable peg or adjustable peg system. This is where a fixed exchange rate is maintained but with a provision for revaluations and devaluations.

6.

SECTION D**Answer Question 6 and any other TWO questions****CASE STUDY**

- (a) The main problem in this case is the decline in the business' performance arising from increased foreign competition.

This has been characterized by

- closure of two manufacturing plants within a period of two years.
- reduction in market share from 21 % to 9% within a period of five years.
- declining productivity, decreasing labour force and increasing customer complaints among other things.

- (b) SWOT stands for

- S - Strengths or positive factors within the organisation
 W - Weaknesses or negative elements within the organisation
 O - Opportunities or advantages outside the organisation i.e. (environmental factors)
 T - threats are negative environmental factors.

Strategies for improving the business performance can be developed by Guta examining more than one of the components of the SWOT as follows:

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In this case the company has the following:

1. Strengths
 - (i) Quality and customer care
 - (ii) A large market share
 - (iii) Qualified, skilled intelligent and courageous staff
 - (iv) Good management and management confidence in staff.
2. Weaknesses
 - (i) Lack of team spirit and cooperation between management and staff
 - (ii) Poor attitude and low morale

- (iii) Poor leadership style – autocratic leadership – old rules and procedures.
- (iv) The company relies on domestic market share only.

3. Opportunities

- (i) A history of success
- (ii) Innovation

4. Threats

- (i) Competition

ST strategies would involve comparing strengths and threats e.g.

1. How can the company win back its customers? By improving its product quality, customer satisfaction and care vis-a-vis its competitors.
2. An SO strategy would involve using strengths to take advantage of opportunities e.g. the well qualified, intelligent, skilled and courageous staff could be encouraged to try innovative ideas such as introducing changes in products and procedures, introducing new products or venturing into export market.
3. WT strategy should be identified for purposes of avoidance e.g. the autocratic leadership has not proved to be good in the face of competition. It has staff at low levels who are likely to know what competitors are doing and should therefore be allowed to make contributions to decisions affecting product innovation and customer care.
4. WO weaknesses must be dealt with in order to take advantage of the opportunities.

- (c) The purpose of SWOT analysis is to help management in identifying internal and environmental elements which may be utilized or eliminated in decision making. A TOWs Matrix helps in developing strategies as follows:

TOWS MATRIX

		Environmental Factors	
		T (Threats)	O (Opportunities)
Organisational Internal Factors	S	ST	SO
	W	WT	WO

- ST - Strategies are strategies that involve using company strengths to combat environmental threats.
- SO - Strategies use strengths to take advantage of opportunities in the environment.
- WT - Involve examining threats in view of a weak company.
- WO - Weaknesses in the presence of opportunities require improving the internal environment in order to take advantage of the opportunities.

7. (a) Motivation is an inner desire or drive in a person to achieve a goal. It is an internal condition based on a person's values, perceptions and needs.
- (b) Motivation theories try to explain bases of the internal condition of a person that make them want to or not want to do something.

The most commonly known theories of motivation are:

- (1) Maslow's Hierarchy of needs:
Maslow believed that the behavior of human beings is based on needs. He believed that needs are arranged in order of importance i.e. hierarchy such as

- Physiological needs
- Security needs
- Social needs
- Esteem needs
- Self-actualization needs.

Maslow believed that people act in order to satisfy these needs and that once a need has been satisfied, it ceases to be a motivator.

- (2) Herzberg's Hygiene Theory
Herzberg's theory is also known as Two-Factor theory because he observed that there are two types of motivating factors known as:

- Dissatisfiers also known as hygiene factors or maintenance factors
- Satisfiers or motivating factors.

Motivating factors include:

Achievement
Recognition
Advancement
Work itself

Responsibility
Growth potential

Hygiene factors include:
Interpersonal relations
Company policies
Job security
Work conditions
Salary

- (3) Vroom's Expectancy Model
Vroom's theory notes that people exert effort in doing something in proportion to what they think they will get out of it. The expectancy theory is classified into:
- Effort – performance expectancy
 - Performance – reward expectancy
 - Reward attractiveness or valence.

- (c) Many conditions of life require motivation because the process of achieving most goals involve unattractive activities. For instance:

- employees might agree to work longer hours if offered a high rate of overtime pay.
- employees might agree to work long periods away from home if offered longer holiday periods.
- employees might be motivated to work had if they are promised promotion.

8. (a) Production involves converting or using some raw materials in order to produce a good or service that satisfies consumer need.

In setting up a production policy, management must consider the following:

- (1) The nature of the product i.e. its design, package, storage, market and the ability to satisfy the intended need.
- (2) The volume of the output, the market need: under-production will annoy customers whereas overproduction is costly in resources and storage cost.
- (3) Technology: i.e. methods and equipment necessary for producing the product must be continuously updated in order to ensure production efficiency.

- (4) The resources required such as raw materials, labour, components, capital equipment.
- (5) Controls such as quality control, volume, cost and price controls and also production process controls.
- (b) Production methods are basically determined by the nature of the product but also by the technology available. Production methods are:

1. Job Production or Unit Production

This is a specialized production of a unit of a product. It involves a “one off” order for a particular customer or client e.g. a suit, a house or a chair.

Advantage: It allows production of customer specified production.

Disadvantage: Production can only be undertaken when orders are obtained.

2. Batch Production

When a number of similar goods are required such as parts of other products. These can be produced together as a batch.

Advantage: Many can be produced at once and save costs.

Disadvantage: The size of the batch is determined by the number of units in production.

3. Flow Production

Flow production is used where there is steady demand for a product and production involves a continuous, repetitive sequence of events and the use of special machines and tools. It is mass production which focuses on speed, accuracy, economy and continuity.

Advantage: Allows mass production of a product.

Disadvantage: An error affects a large number of units and results in large losses.

4. Process Production

This is a special type of flow production where the product passes through a succession of processes. The output of one process becomes an input into the next process.

Advantage: Makes it possible to know and control the cost of production at all stages of production.

Disadvantage: The quality of one output affects the output of the next processes.

9. (a) Delegation is the act of investing authority in a person to act for another. It involves transferring to lower levels of staff the responsibility for performing given tasks or duties and making management decisions consistent with the duties to be undertaken.
- (b) In delegating a task to a subordinate, the following procedures should be followed:
1. Define the task:
To ensure that the delegatee understands what they are supposed to do, breakdown the job into smaller tasks or shorter periods including objectives expected to be achieved.
 2. Provide the delegatee with all the necessary information:
Communication should be in writing for the subordinate to refer back to. He/she should also be informed if there are other people affected by the task.
 3. Assign authority:
The level of authority allowed should be in line with the size and nature of the job. Sufficient authority should be conferred on the delegatee to reduce the need for constant reference to the delegator. Authority should be specific, indicating the parameters and duration of such authority.
 4. Set goals:
Set goals and let the subordinate decide how he/she is going to achieve the goals. The subordinate should know what is to be accomplished.
 5. Follow up:
Provide ways of allowing the delegatee to inform you about progress and to seek assistance when in trouble.
 6. Give credit:
Recognize good work and publicly, privately and promptly acknowledge and reward where necessary.
- (c) Delegation is advantageous to the organisation because:
1. It allows the supervisor time to take on more challenging work.
 2. Delegation improves employee morale.
 3. It provides opportunity for on the job training for subordinates.
 4. It creates trust and a sense of responsibility.

END