



ACCOUNTING FUNDAMENTALS

Online exam

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Question 1

Wales Ltd makes and sells product X. The current selling price is £20 and the total of variable costs per unit is £11. The fixed costs of production are £450,000 and the company currently sells 60,000 units.

Required:

- (a) Calculate the break-even point (in units and revenues) of product X for Wales Ltd.
- (b) Calculate the profit made on sales of 60,000 units.
- (c) The company will make an advertising campaign costs £100,000 and will improve the product specifications, which will increase the variable cost per unit by £1. This is expected to allow the company to increase the selling price to £22 and the sales is expected to be 62,000 units. Calculate the new profit figure for the improved product.
- (d) Discuss the limitations of break-even analysis.

a)

Break-even point

Fixed costs	450000,00
Total sales	60000,00
Price per unit	20,00
Variable costs	11,00
Contribution per unit	9,00

a)

Break-even point	<u>450000,00</u>
	9,00
	50000,00

b)

Profit $(60000,00 - 50000,00) \times 9,00 = \mathbf{90000,00}$

c) Profit - condition 2

	Advertising 100000	
Fixed costs	450000,00	550000,00
Total sales	60000,00	62000,00
Price per unit	20,00	22,00
Variable costs	11,00	12,00
Contribution per unit	9,00	10,00
Break-even point	550000,00 10,00 55000,00	

Profit $(62000,00 - 55000,00) \times 10,00 = 70000,00$

d) Limitation of Break-even analysis

Break-even analysis has a number of uses but is limited in several ways. Some of the limitations are as follows:

1. New entrants to the market will often force the price down and may affect the expected sales levels.
2. The assumption that all output produced is sold can often be highly unrealistic. This is possibly true for a firm operating in a market where the firm is small in relation to the size of the overall market.
3. The distinction between fixed and variable costs is not as easy as this may have implied.
4. A fixed cost will be fixed over a particular range of output.
5. If a firm producing more than one type of product, it becomes very difficult to separate out the fixed costs individually.

Question 2

- a) Discuss the importance of management accounting, and how it differs from what financial accounting provides.

Management accounting, also referred to as managerial accounting, is used by managers and directors to make decisions regarding the daily operations of a company. A distinguishing feature of managerial accounting is that it is not based on past performance, but on current and future trends. For example, determining how much your business should charge for a new product and analyzing how much revenue a future product line is capable of generating are both examples of business problems within the field of managerial accounting. So, too, is deciding when to replace the computers in your offices. Since business leaders constantly need to make operational decisions in a short amount of time, management accounting must rely on predicting markets and future trends.

Financial accounting is used to present the financial health of a company to external stakeholders. This allows the board of directors, stockholders, potential investors, creditors, and financial institutions to see how the company has performed during a specific period of time in the past. These reports are filed on an annual basis. If a business is considered a publicly traded company on the stock market, the reports must be made part of the public record. In a financial accounting course, students learn how to prepare, read and analyze financial statements.

There are two primary differences between financial and management accounting. The first difference is that management accounting is presented to a company's internal community, while financial accounting is prepared for an external audience. Even though financial accounting is of great importance to current and potential investors, management accounting is necessary for managers to make current and future financial decisions for their business. The second difference is that financial accounting is exact and must adhere to Generally Accepted Accounting Principles (GAAP), while management accounting can be based off a guess or estimate since most managers do not have time to get exact numbers by the time a decision needs to be made.

- b) Discuss three techniques by which the management accountant can achieve the objectives of management accounting.

1. Decision Making:

Whenever there are different alternatives of doing a particular work, it becomes necessary to select the best out of all alternatives. This requires decision on the part of the management. The management accounting helps the management through the techniques of marginal costing, capital budgeting, differential costing to select the best alternative which will maximize the profits of the business.

2. Revaluation Accounting:

The management accountant, through this technique assures the maintenance and preservation of the capital of the enterprise. It brings into account the impact of changes in the prices on the preparation of the financial statements.

3. Cash Flow Statement:

A funds flow statement based on increase or decrease in working capital is very useful in long-range financial planning. It is quite possible that there may be sufficient working capital as revealed by the funds flow statement and still the company may be unable to meet its current liabilities as and when they fall due. It may be due to an accumulation of inventories and an increase in trade debtors.

References

Horner, D., 2013. *Accounting for (non) Accountants*. Ninth ed. London: Replika Press Pvt Ltd.

