

Managing Accounting
LCBB5002
Assessment 2
“Variance Analysis and Relevant Cost”



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Introduction:

The aim of this paper is the analysis of the variances, how the company measure the manager performance using the variance analysis, which advantage and disadvantage can carry within the company for managers' performance.

In part B, we will discuss if due to the given circumstance that the company XLG face it would be better to produce in-house or keeping outsourcing from Brazil.

The pandemic has impacted in the business organizations making them to restructure their strategies and manufacturing, making to reorganize their productions and cost. Therefore, we will try to understand the solutions that we can find through the scenario.

The discussion report of this paper is how decisions should achieve the objectives of the company. This paper involves the relevant advantages and associated costs. Not all the cost are relevant so it is important to distinguish between those cost that can lead to poor decisions.

This paper is divided in two; part A and Part B, we will get the different variances if there is any different with the actual performance to understand the new strategy and if it favourable or unfavourable.

Then, we will talk in part B of those cost that can affect the company to make the decision during the scenario, which relevant cost can affect the decision of the manager and we will give examples and an argumentation of it.

2.1 Part A:

Question 1.

A. The sales price variance and sales volume contribution variance. (12 marks)

Sales price variance = (actual price – standard price) x actual volume

Description	Actual Price	Standard Price	Difference	Actual volume	Sales price volume
Chemical X	£45	£35	10	850	8,500 F
Chemical Y	£37	£30	7	750	33,000 F
					41,500 F

B. Sales Volume contribution variance = (actual sales volume - budgeted sales volume) x standard margin.

Description	Actual Sales volume	Budgeted sales volume	Difference	Standard margin	Sales price Variance
Chemical X	850	595	255	£25	6,375 F
Chemical Y	750	595	155	£20	3,100 F
					9,475F

C. The material price planning variance and material price operational Variance.

Material planning variance = (original target price – general market price at time of purchase) x quantity purchased

$$(\text{£}2.50 - \text{£}4.50) \times 1600 = 3,200 \text{ A}$$

- The material planning variance is unfavourable as it would cost more as what the company has budgeted.

Material price operational variance = (general market price at time of purchase – actual price paid) x quantity purchased

$$(\text{£}4.50 - \text{£}3.70) \times 1600 = 1,280 \text{ F}$$

When there is an unfavourable variance, we need to identify the cause so we can take action through the material price variance analysis. Therefore, we use the variance analysis to identify problems and find alternative to control cost in the future.

An unfavourable price variance at XLG might have been a result of a high demand for material caused a supplier to raise prices or in this scenario is that the supplier due to the pandemic need to use different via of transportation.

A. Given the change in operations, critically analysis the merits and demerits of using variances in assessing managers performance.

Every company focus in maximize the benefits and achieve goals and objectives; companies use different way to measure the employee's performance. We will explain the financial performance through the variance's costs of the companies.

The variance's cost is a financial performance (Okafer, 2006) where managers measure the actual results that is given from the budgets and compare if the line of the cost, price and volume are under control.

We will criticize the merits and demerits in managers performance using variances. Some authors said that when data adhered to the plan but the result of the difference between the standard cost and actual result is called variance analysis (Brown,2012). In different words the standard cost is compared to the actual cost.

The starting point of this section is using the accounting terminology; a standard cost is known when the cost of each product is compared with the actual cost to determine the efficiency of the operation. Managers use this tool because allow a better cost control and help to a better utilization of the resources.

The purpose of measuring the performance of the manager within the organization according Lockett (1992) is that using the variance analysis can enable the achievement of high standard of performance, it will be allowed employees to do the right task and it would identify the barriers and doing this will improve the performance of the employees resolving those barriers.

In this section we will investigate the advantages and disadvantages of using the variance analysis. Putra (2019) state that this accounting tool could bring some benefits to the company such allowing cost control, improving the communication within the organization and performance to achieve the objective. Managers are requiring explaining the unfavourable variances which force them to identify problems to be tackled. When manager know that produce favourable variances will help them to plan for the future.

In the scenario that has given when the demand increases due to external factors managers need to adjust the budgeting to the demand. Flexible budgets will help to adjust to the demand, using the technique of cost-volume-profit analysis will evaluate the effect of forecast changes in sales, variable cost and fixed costs. This technique will also assist to decision-making such if it is necessary to buy more material or not, if the production needs to be in-house rather than buy outside, we have to take into account that labour cost vary with the with the volume.

Therefore, if the variance that increase the profit beyond the budgeted profit its is called a favourable variance (Atrill, Peter, and Eddie McLaney, 2018).

Within the disadvantages of using variance analysis to measure the performance it can led to neglect some tools that we have seen above from the managers perfective.

As managers can cover-up unfavourable variances and it takes long time to examine the effect of the variances and therefore correction action as well. Managers may overestimate material quantity, labour cost and material price per unit. Thus, when this happen it called budged slack, which managers look good even if costs are higher than budged,

Neves (2010) pointed out that reducing the cost associated with use of variance analysis, some recommendations that the author stated is that need the price variance to identify problems and not insolate each material because an unfavourable direct material may be caused by external factors. He also said that an improvement in a particular variance it is not always good for that company because it make some performance looks good.

Another research about variance analysis performance said that can shape the manager's behaviour toward the reaching its goals (Jeffrey R. Cohen and Laurie W. Pant, 2018). Many managers use variance analysis only to determine a short-term reaction, and do not analyse why the variance occurred from a long-term perspective.

To summary this section managers need to take correct decision using the standard cost systems to be focused in the problems that might be present during the operations because can affect to the objectives of the company.

Part B

In Part B we will critically analysis the relevant cost that decision making can make and the advantages of making the product in-house or outsourcing the products from a supply. Each decision involves many choices, when making a decision cost and benefits need to be compared with different alternatives. The point to analyse the cost is to distinguish which cost are relevant and which are irrelevant. Irrelevant cost can be ignored which will help to optimise resources and time for managers (Garrison & Noreen, 2012).

Relevant cost is any cost that is influenced and affected by decisions, in decisions making the cost can incur in different ways. Those cost that are future cost that differ among alternatives and can make different when you make decisions (Victoravich L. M., 2010).

- Opportunity cost – it is the cash flow that is sacrificed as a result of a particular management decision.
- Differential cost – it is the incremental cost that would be incurred by decisions.
- Avoidable cost – those cost that can be avoidable by decisions

Those cost that have been already uncured and cannot be changed is known as a sunk cost, per example a purchase the machine cannot be recovered.

Relevant cost helps the company to assess whether the company have a loss and if it is viable in the short-term. Nowadays, consumers are more demanding and looking everything at the best price. According to Kaplan (1990) the company must master revenues and cost to make profit. The relevant cost can vary according the circumstances.

When we talk about in-house production, the XLG must include expenditures related to the sales and maintenance of any equipment and the cost of production materials. It needs to see the additional labour cost that require to produce the product and the storage costs.

Buying costs of the products from a supplier or outside source need to be included the price of the product itself.

In this scenario it said that the product FAMEQ gives an advantaged and the demand due to the circumstances is exponential increasing. If the cost of making the FamaQ in the UK is £3 and what the

company is paying is £3.70 with the outsourcing in Brazil with the upcoming landscape of the pandemic increasing the prices will be more expensive and it may take longer. The difference is £1.20 and £50, if we outsource in the UK we will save 1.20 but as the demand is increasing, we will need to look into that as the price raise up if it would be reasonable to produce in the UK, with less cost and faster.

We will see the differential cost in the product FameQ between manufacture in UK or in Brazil which would be less costly to manufacture in-house as the demand increases. Which we take this cost a relevant for a decision

Some factors may influence the company's decision to make or buy the Fame Q product, it could be the lack of in-house experience, they prefer a multiple supplier, and the product may not be critical to the company's strategy. Companies take the consideration especially if the outsourced company has previously worked has made their products and they have a sustain long-term relationship.

The argumentation of the transaction cost made by Williamson (1985) is that the company will make the outsourcing decision on the aim to reduce transaction cost and production. Production cost refer to the direct cost involved in creating the product and transaction cost include the cost of selecting supplier. Which given this scenario, that making the unit in the UK will give

Another factor as Moschuris (2007) framework said that this decision needs to be on based of the cost and quality of the product. As per the scenario given, we saw that the FameQ cannot be replaced and gives an advantage, furthermore, products Y and X are increasing the sales due to the demand, therefore, FameQ will do.

Moschuris (2007) carried out that typical problems of outsourcing is the lack of knowledge, economic issues, in this case the scenario is that due to the pandemic the company have moved their sales online, and organization changes.

Furthermore, Mantel (2006) and McIvor (2003) said that some of the reason of making the product outside are the cost reduction as in some cases the activity can be performed at a lower cost. They said that reducing risk of exposure (converting fixed cost into variable costs) the company through outsourcing reduce the level of risk as supplier can adapt and cope with demand. Also, companies can be more flexible by outsourcing rather than making in-house, as they could react to the market and be more responsive to customer change.

However, as the unprecedented situation, exporting the product from Brazil with the increase price on it will not be the best option because the rentability will not be high. Therefore, making the product in the UK could save costs and profit for the company. If the company still outsourcing from the supplier in Brazil one of the main issues could be fall through their end of the deal or the reschedule of the order. During the pandemic we saw that deliveries and supplier can take longer than expected, knowing that the pandemic can affect different countries in different ways, those emerging countries like Brazil could suffer a social instability which could lead a lockdown of the country.

Conclusion

In conclusion in order to buy or make the product FameQ there many factors that we need to get in consideration, relevant cost and what it comes with it can give a better understanding of which decision is better to take as a manager. We have been seen different argumentations that are in favour of outsourcing

or make it in-house but not all have been given a understandable economical and world context that the company is going through, but what it is the important are the factors that XLG must adjust and it is working with suppliers it can be easier to achieve flexibility, efficient and agile supply chain.

We saw in this paper that some factors are related to costs and decisions that understand how buying the product could affect the XLG company operations specially when it is going through an uncertain period and the prices are raising up due to factors that are affecting the costs. The decision-making from managers to decide and get in consideration costs are the tool to decide if it is better to make or buy it.

To carry with the question if which would be the best alternative, with the relevant cost that is given in the question the company XLG should make the fameQ in UK as the demand would increase 45% and more quantity would be needed, but the company we will take a risk for the new manufacture strategy as it might not be coped with the demand.

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