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LLEOLIAD: LLUNDAIN

LEVEL 4

LEFEL 4

EXAMINATION PERIOD
JUNE 2021 TERM

CYFNOD ARHOLIADAU
MEHEFIN 2021 TYMOR

MODULE CODE: LCBB4001
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ACCOUNTING FUNDAMENTALS

TIME: 9:00AM TO 4:00PM

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Date & Time : 27.08.2021 & 09.00 AM

QUESTION 1

Kerrigan Ltd makes and sells product A. The current selling price is £11 and the total of variable costs per unit is £6. The fixed costs of production are £350,000 and the company currently sells 75,000 units.

Required:

- (a) Calculate the break-even point (in units and revenues) of product A for Kerrigan Ltd. [10 marks]

£

Contribution per unit is selling price minus the variable costs.

$$11 - 6 = 5$$

Break-even point (units) is fixed costs divided by the contribution unit.

$$350,000/5 = 70,000$$

Gross profit/Contribution is units that the company currently sells times contribution per unit.

$$75,000 * 5 = 375,000$$

The gross profit margin is calculated by dividing gross profit by sales times 100%.

$$375,000/825,000 = 0.45454545$$

Break-even point (revenue) is fixed costs divided by gross profit margin.

$$350,000/0.45454545 = 770,000$$

Short way is break-even point (units) times selling price.

$$70,000 * 11 = 770,000$$

- (b) Calculate the profit made on sales of 75,000 units. [10 marks]

£

$$\text{Revenue is } 75,000 * 11 = 825,000$$

$$\text{Variable cost is } 75,000 * 6 = 450,000$$

$$\text{Fixed cost is } 350,000$$

$$\text{Total is } 450,000 + 350,000 = 800,000$$

$$\text{Profit is } 825,000 - 800,000 = 25,000$$

Short way is calculated by taking the units that the company sells and minus the break-even point units and the answer to be times by the contribution unit.

$$(75,000 - 70,000) * 5 = 25,000$$

- (c) The company will make an advertising campaign costs £10,000 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 £13 and the sales is expected to be 80,000 units. Calculate the new profit figure for the improved product. **[15 marks]**

£

New sale price: 13 (this is given)

New Variable cost: $6 + 1 = 7$

New Contribution per unit: $13 - 7 = 6$

New Fixed Cost: $350,000 + 10,000 = 360,000$

Breakeven point = $360,000 / 6 = 60,000$

$(80,000 - 60,000) * 6 = 120,000$

- (d) Discuss the limitations of break-even analysis. **[15 marks]**

While the break-even analysis supports a company to know their break-even and margin safety, it also has several limitations.

The first one that I would like to mention is that fixed costs are the same only to a precise moment. For example, some factors could make some of the bills to go up. The increase or decrease in fixed costs is not depended on the level of the business activity or production like variable costs. They could vary because of some output changes.

Another limitation is that the data needs to be accurate as if it's not then the data is not dependable, and the break-even analysis are wrong.

Competition is another factor that is not included in the analysis and if there's a demand in one of the products and the selling price changes then this might affect the break-even point. The break-even analysis only tells a company the break-even point, but it cannot predict future demands.

Many organizations sell different products with different prices, and this cannot be shown in the break-even analysis as it only suits companies with one price point.

QUESTION 2

- (a) Discuss the importance of management accounting, and how it differs from what financial accounting provides.
[25 marks]

First, I will start by explaining why management accounting is important. The main reasons are to make the right decisions and to be able to expand the business. It gives us specifics of the company performance based on genuine data by splitting what's important and what needs to be improved. Management accounting helps us to plan and to make strategies for our business, to achieve objectives and to help the management to motivate and control better. It also helps the board to inspect and validate the operation of each department of the business. Another advantage is that it helps for the overall efficiency of the business by placing targets for each unit and making sure they are all completed in a timely manner. It also ensures that available resources are allocated appropriately.

I would like to also explain what's financial accounting before I identify the differences between management and financial accounting. Financial accounting is the reporting of the transactions for a set period, creating the financial statements which are balance sheet, income statement and cash flow statement. These reports show the performance for a particular time. They are mainly used by parties outside the organizations like creditors, suppliers, customers, and investors. Financial accounting helps management to allocate their resources in the right way and to make new business partners. It also helps to keep track of all transactions and to attract investors into their businesses.

The main difference between financial and management accounting is who it provides the information to. As explained above, financial accounting delivers information to the outside organizations and management accounting provides details to the internal management. The second difference is how the information is presented – management accounting could be modified and does not need to comply with any principle as it's only presented internally but financial accounting must be prepared according to the GAAP standards. Management accounting reports are mainly used to improve business operations while financial accounting reports are used to inform the outside on whether to lend or invest in the business. Another difference is that financial accounting shows the profit of the company and management accounting concentrates on problems and finding ways to fix them.

- (b) Discuss three techniques by which the management accountant can achieve the objectives of management accounting.
[25 marks]

As per above, management accounting is concentrating on internal reporting and supports managers to accomplish goals by using different techniques. I will discuss three of these techniques below.

The first one is budgetary control which helps us to plan and control costs. This is a technique that is commonly used by accountants to be able to plan all activities in the business. It also helps management to have the required goals accomplished. Budgeting helps managers to analyse the information so they can make vital decisions. Budgets are always prepared in advance so we can make decisions for the future. Usually, we update the previous year's budget with the new figures for this year.

The second one is historical cost accounting which gives us past data so we can compare with the standard costs. This is beneficial for cost control and planning for the future. Costs are detailed after being incurred and are applied to evaluate the company's performance.

The third technique is cash flow analysis which shows the movement of cash of a particular period. It shows us not only the changes of cash balances but also the cash from operation. This statement is valuable as it demonstrates us cash inflows and outflows. It is also very useful for liquidity analysis. Most companies use accrual basis of accounting. We use this technique, so we are sure that we have enough liquid assets to cover the short-term debts.

References

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