

MODULE CODE: LCBB4001 ACCOUNTING FUNDAMENTALS

Assessment 2

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Answer to the question 1

a) Calculate breakeven point (in units and revenues)

Product A	
	£
Selling price	11
Variable cost	6
Fixed costs	350,000
Unit sales	75000 units

Break even (units) = Fixed costs/ (Selling price- variable cost)

$$= 350,000/ (11-6)$$

$$= 70,000$$

The company needs to sell 70,000 units to break even

Break even in revenues = fixed costs/ {(sales- VC)/sales}

$$= 770,000$$

B) Profits made on sales of 75000 units is \$25000

Contribution margin = price per product 11 – variable cost per product 6 = 5

Breakeven point 70,000 - Units of sales 75000 =5000

Thus, the profits made on sales in (5000*5) = 25000

c) Ad cost 10,000,

New variable cost 7,

New sales price 13,

Expected sales unit 80,000

The new profit figure for the 80,000 units will be \$130,000

Contribution margin = 13 (price) – 7 (VC)

= 6

New breakeven point = 58,333 (Applying the same formula)

Number of units = 80,000

Therefore, the gap between break even point and units of sales is $(80,000 - 58,333) = 21,667$

The profits generated on 80,000 units would be $(21,667 \times 6) = 130,000$

d. Limitations of breakeven analysis

The following are the limitations of breakeven analysis:

- The competitors or market competition is not taken under consideration in this equation.
- New products in the market can critically affect the demand of the company's products. Break even analysis does not take account of the new products entering the market.
- A clear-cut division of the company's costs into variable and fixed costs is not always practical.
- Breakeven analysis often relies on unrealistic assumptions. For example, not all products are sold at the same price when there are differences in the levels of output. Fixed costs also change with the changes in outputs (Kaplan and Atkinson, 2020).

Answer to the question 2

a. The importance of management accounting

Management accounting is important because it assists managers in making decisions. The report provides with information and financial data needed for management decision making (Bhimani, Horngren, Datar and Rajan, 2020). Unlike financial accounting reports, management accounting doesn't only focus on the historic performance of the company but instead focuses making calculated predictions (Drury, 2020).

There are different types of management accounting reports including budget reports, cost management accounting reports, performance reports, accounts receivables aging report, job cost reports etc. (Drury, 2020). Each has its own importance in the respective management decision making processes. Budget report, for example, helps assess the previous budget performance and what the actual costs were against the budgeted expenditures (Hansen and Mowen, 2007). Thus, the managers are able to make adjustments or improvements in the company's budgets when necessary.

Accounts receivables aging report helps identify and organize the open invoices and make decisions regarding slow paying clients. Job cost reports help managers to assess the profitability of each job and identify the expenses relating to particular job positions (Horngren et al., 2020). Thus, the managers can make decisions regarding the workforce.

Management accounting enables managers to make data-based decisions. In management accounting process, data are gathered from related organizational documents and reports for preparing management reports, which then facilitate making strategic decisions based on data and information (Kaplan and Atkinson, 2020). Thus, the reliability of management decisions is enhanced in this process.

Management accounting also increases efficiency of the organizational decision-making processes. Using data and findings of the management reports, the managers can efficiently make the right decisions for the organization, instead of relying on hunches or spending more time in meetings and conferences (Kaplan and Atkinson, 2020). Management accounting reports help relevant parties visualize the patterns of data and get reliable forecasting, which make it faster and more efficient for them to come to specific conclusions and decisions.

How it differs from what financial accounting provides

On the other hand, financial accounting helps keep track of financial transactions. The key objective of financial accounting is to prepare accounting reports for a specific period to communicate the company's financial performance and condition for that accounting period (Kaplan and Atkinson, 2020). Financial accounting procedures follow a set of international standards and guidelines that help prepare consistent and comparable financial statements (Hansen and Mowen, 2007). Financial statements are made for a larger group of audiences including the external stakeholders. Investors can make investment decisions based on the financial accounting data, business clients can consider the prospects of the company in business transactions, regulatory bodies can evaluate the compliance to regulations and policies, etc. (Seal, Rohde, Garrison and Noreen, 2020). Management accounting doesn't serve any of these purposes because the reports prepared in management accounting are not intended for a larger group of audiences. They are only to facilitate and support management decision making (Hansen and Mowen, 2007). Therefore, usage-wise, there are many differences between management accounting and financial accounting.

b) Three techniques by which management accountant can achieve the objectives of management accounting

The objectives of management accounting are to maximize profits and minimize losses. Making more effective and outcome oriented strategic management decisions is also considered as an objective of management accounting (Bhimani, Horngren, Datar and Rajan, 2020). In other words, the key objectives of management accounting include facilitating management decisions that help achieve profit maximization and wealth maximization objectives of the company (Drury, 2020). The following are three techniques by which management accountants can achieve these objectives.

1. Capital budgeting: Capital budgeting technique is used for making calculated decisions regarding capital expenditures and investments (Hansen and Mowen, 2007). As mentioned earlier, one of the objectives of management accounting is to maximize profits or returns, and minimizing the losses. Using capital budgeting techniques such as Net Present Value, Accounting Rate of

Return and Payback Period, managers can make decisions involving capital expenditure or investments that maximize returns for the company (Drury, 2020). This way, the shareholders' stakes at the company are better protected. For instance, NPV calculation helps select a project or investment option with potentially higher returns considering the time value of money. Payback period calculation helps choose a project or investment option that would generate faster returns.

2. Margin analysis: By definition, marginal analysis refers to “the examination of the associated costs and potential benefits of specific business activities or financial decisions” (Hansen and Mowen, 2007). Margin analysis helps assess whether a change in an activity would result in benefits that offset the costs. It is considered one of the essential techniques in management accounting. Calculation of break-even point is a margin analysis that helps investigate the optimal sales mix for the products or services of a company (Horngren et al., 2020). Margin analysis also helps choose between investment options by estimating the costs and benefits, when there are only funds available for one (Kaplan and Atkinson, 2020).

3. Trend analysis and forecasting

Trend analysis and forecasting by assessing the patterns of data and detecting unusual variances in values help managers make strategic decisions regarding business operations or product marketing (Kaplan and Atkinson, 2020). Using this technique, managers project certain future outcomes involving market trends, changes in inventory levels, sales growth/drop, and interest rates (Seal, Rohde, Garrison and Noreen, 2020). Thus, the managers maintain greater control over the profitability of operations and it is also easier for them to avoid risks that would incur result in significant financial losses.

References

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