



ACCOUNTING FUNDAMENTALS

LCBB4001



Assignment- A2

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QUESTION 1

a)
Contribution per unit = Selling price per unit - Variable costs per unit
Contribution per unit = 20 - 11 = £9
Break-even point = Fixed Cost / contribution per unit = 450 000 / 9 = 50 000 units
b)
Profit = (60,000 - 50,000) X 9 = £90 000
c)
New selling price = £22
New variable costs = £12
new contribution = 22 - 12 = £10
New fixed costs = 550 000 (450 000 + 100 000)
New sales volume = 62 000
New BEP = 550 000 / 10 = 55 000 units
Profit = (62 000 - 55 000) X 10 = £70 000
Sales (sp x units)
i.e. less profit

d)

The main purpose of the Break-Even Analysis is to determine the break-even point that must be passed by the company to start making a profit. This is also a useful tool in both production control and risk forecasting within the company. However, this analysis has certain limitations that reduce its effectiveness.

These include the fact that the analysis is not dynamic but a static snapshot at the time it is made. It does not consider cash flow or the timing of production or periodic changes in raw material costs for example. In fact, if these were to increase in price, the Break-Even Analysis would not be able to keep up to date in its processes.

Another limitation is inventories, which are not considered. The BEP formula considers the units produced to correspond with those sold, i.e., it assumes that what is produced is also what is sold and therefore does not take into account what regularly happens in all production companies, i.e. inventories.

Moreover, costs and revenues do not always vary linearly. Variable costs (e.g., of certain raw materials) are subject to change over time, even in the short term. Break Even Analysis does not consider the variation of Vc (Variable Costs) with respect to the units sold and invoiced. If the price of the raw material increases, it will be necessary to recalculate the BEP, the same in the opposite case where the variable cost of the raw material decreases for example because of a supplier discount granted on a large quantity.

Another limiting factor of this analysis is that it is difficult to calculate when the company sells more than one type of product. It very often happens that turnover is generated by the sale of products with a different cost structure, e.g., it may produce both food and personal wellness products. In these cases, it is more complex to determine the break-even point as one must consider the different costs of each and the revenue share for each product type (product mix).

The last factor that is not considered is competition. Should competitors change their sales prices, influencing the market and consequently changing the trend in demand, the company too will necessarily have to review its sales price policy and the conditions applied to remain competitive in the relevant sector.

Although these aspects somewhat limit the Break Even Point, this does not detract from the fact that the analysis is nevertheless effective for forecasting purposes and can be validly used in the drafting of a business plan.

Question 2

a)

Financial accounting and management accounting are two divisions of accounting that are of great importance to an organization.

These two main branches of accounting deal with two separate fields but depend on each other.

Management accounting deals with the finance side of the organization. The information revealed by management accounting is mainly used by internal staff, such as managers and employees. Management accounting is more used in strategic management and useful in decision-making by organization. Since it is used by internal staff to plan and control business activities, there is no set period for this process.

Management accounting uses financial and non-financial information in management reports. The main areas covered by management accounting are break-even point, cost behavior, capital budgeting, profit planning, standard costing, relevant decision-making costs, and activity-based costs. The cost calculated in the management accounting process is subsequently used in the cash flow statement.

Financial accounting is primarily concerned with providing data that can be presented to external parties of the organization, which may include banks, creditors, and shareholders. In addition, this field can provide and represent the overall performance of the company over a certain period.

The differences between financial accounting and management accounting are:

- Management accounting can focus on specific areas of the organization and help them in decision-making. But financial accounting caters for the entire organization, combines all costs and revenues together and provides an overall view by the end of a specific required period.
- Management accounting deals with financial and non-financial information such as, for example, productivity or sales volume. However, financial accounting is exclusively based on the monetary concept.
- Financial accounting presents historical data of company performance, management accounting although it mainly focuses on the analysis of historical performance, also includes company trends and forecasts.

b)

The three techniques by which the management accountant can achieve the objectives of management accounting:

Break-even Analysis

Break-even analysis is the point at which total cost and total revenue are equal, i.e., 'even'. There is no net loss or net profit and therefore you are at a break-even point.

The break-even point represents the number of sales, in terms of units (quantity) needed to cover total costs, consisting of both fixed and variable costs for the business. The total profit at the break-even point is zero. A company can only exceed the break-even point if the monetary value of sales is higher than the cost. This means that the sales price of the good must be higher than the price the company initially paid for the good, i.e. it must include all raw material costs and/or the costs to produce it.

Once the break-even price is exceeded, the company can start to make a profit.

The main purpose of this analysis is to determine the minimum output that must be exceeded for the company to make a profit. It is also a rough indicator of the profit impact of a marketing activity. A company can analyze ideal output levels to be informed about the number of sales and revenues that would meet and exceed the break-even point. If a company does not reach this level, it often becomes difficult to continue operations.

Budgeting

The corporate budget is the result of a series of processes by which corporate objectives can be set in the short term. by summarizing the company's historical data and both economic and financial results over a given period. In this way, the company can roughly define future ones.

It is practically a form of management control that allows the assessment of a series of future economic results and objectives, based on careful analysis. The corporate budget helps to define future strategies and actions based on well-defined objectives.

The company budget enables the company to achieve the maximum attainable profit in the period under consideration, thanks to a planning developed ad hoc. In this way, the company, whatever its size, can organize its work and projects according to its objectives and timeframe. These are important guidelines for all groups to make their work effective and productive.

The company budget is a real budget that allows the company budget to be improved. The purpose of the corporate budget is to define precise and, above all, concrete objectives.

Capital investment appraisal

Capital investment analysis or investment appraisal is one of the most important aspects for the company as it concerns a series of calculations that must be made for an investment in general.

The investment appraisal therefore aims to carefully evaluate various business points of view such as: the strength of the investment, business, and competitive analysis. All this is aimed at maximizing cash flows

and the realization rate of the investment itself. This investigation is dynamic and in continuous development, i.e., it will be carried out considering the different relationships between the investment in the current and future context, comparing the level of evolution of the markets and the competitive environment.