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Management Accounting

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Assignment 2

REPORT

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Sales Price Variance and Sales Volume Contribution Variance Report

XLG

Sales Price Variance Report Q2 2020

	Product X	Product Y
Actual Selling Price	£45	£37
Less: Budgeted Selling Price	£35	£30
Difference in Price	£10	£7
Multiply by: Actual Sales Volume	850	750
Sales Price Variance	£8,500 (f)	£5,250 (f)
*Sales Price Variance based on the following formula: (Actual Selling Price – Budgeted Selling Price) * Actual Sales Volume		

XLG

Sales Volume Contribution Variance Q2 2020

	Product X	Product Y
Actual Sales Volume	850	750
Less: Budgeted Sales Volume	595	595
Difference in Units	255 units	155 units
Multiply by: Standard Contribution Margin	£25	£20
Sales Volume Contribution Variance	£6,375 (f)	£3,100 (f)
*Sales Volume Contribution is based on the following formula: (Actual Sales Volume – Budgeted Sales Volume) * Budgeted Contribution Margin per unit		

The favorable variance for the company's Sales Price Variance Report shows that the company's total selling price exceeded the targeted selling price for both Products X and Y. Higher prices are, in part, due to the higher cost of raw materials.

XLG is among the industries that saw an increase in sales during the pandemic as shown in the favorable variance for the company's Sales Volume Contribution for the second quarter.

XLG Company Material Price Planning Variance and Material Price Operational Variance Report

XLG

Material Price Planning Variance Report Q2 2020

	Product X	Product Y	Total
Standard Material Cost	£2.5	£2.5	£2.5
Less: Revised Material Cost	£4.5	£4.5	£4.5
Difference in Price	-£2	-£2	-£2
Multiply by: Actual famaQ Used*	850 units	750 units	1600 units
Material Price Planning Variance	-£1,700 (A)	-£1,500 (A)	-£3,200 (A)
*Actual Materials Used Assuming total sales is equal to total production	850 units sold x 1 unit famaQ	750 units sold x 1 unit famaQ	1600 units sold x 1 unit famaQ

* Assuming total sales is equal to total production.

**Material Price Planning Variance based on the following formula:

(Standard Price – Budgeted Selling Price) * Actual Sales Volume

Since actual prices have increased compared to the original standard cost, total materials price planning variance for famaQ is adverse.

XLG

**Material Price Operational Variance Report
Q2 2020**

	Product X	Product Y	Total
Actual Material Cost	£3.7	£3.7	£3.7
Less: Revised Material Cost	£4.5	£4.5	£4.5
Difference in Price	£0.80	£0.80	£0.80
Multiply by: Actual units used in production	850 units	750 units	1600 units
Material Price Operating Variance	£680 (F)	£600 (F)	£1,280 (F)
*Actual Materials Used Assuming total sales is equal to total production	850 units sold x 1 unit famaQ	750 units sold x 1 unit famaQ	1 6 0 0 units sold x 1 unit famaQ

* Assuming total sales is equal to total production.

**Material Price Operating Variance based on the following formula:

(Standard Price – Budgeted Selling Price) * Actual Sales Volume

Based on the information above, the company is purchasing raw materials below the current market price. Despite the fact that the cost is higher than the original standard cost given the current market conditions.

Merits and Demerits in Using Variances to Appraise a Manager's Performance

Variances are one of the most widely used tools for financial planning and analysis. At the same time, it is a crucial tool for risk and control management within the organization.

Senior executives of Fortune 500 companies ranked the importance of using variance analysis at 8.7 out of 10 (Conine Jr. and McDonald, 2018). In the same survey, all 154 respondents used variance analysis to compare the current year budget with the actual results for the current year. While the results are not surprising, this only shows how important variances are for organizations even during unpredictable times like today.

Managers Know and Understand the Importance of Variances in Assessing Their Performance

Among the biggest advantage of using variances is its wide acceptance. Managers and employees are aware of the targets they need to hit and any rewards that come with it. Variance reports and analysis are also one way to align the goals of a manager and the unit under him with the organization as a whole.

Ideally, variances could help the company weed out incompetent managers or detect any irregularities in the production process. With the sudden shift in company operations worldwide there would be challenges in using variances to assess a manager's performance.

Standard Budgets are Based on Outdated Information

With the ongoing pandemic, the company's variances based on standard budgets would mostly be unfavorable. Standard budgets were already in place when the pandemic hit the hardest.

In the case of XLG, top management was ill-prepared to deal with the disruption in the supply chain. This eventually caused higher procurement cost which would render standards costs outdated. This could make it difficult for managers to assess the goal they need to work towards.

Reviewing Standards are Crucial to be a Fair Measure of Manager Performance

With the shift in the global scenario, it's also crucial to assess the most realistic targets for all departments.

For XLG, a company producing cleaning products, sales prices for both X and Y increased by 29% (£30 to £35) and 23% (£30 to £37), respectively. Although standard costs for raw materials were revised, the performance of the Purchasing Department could be less than stellar compared to the Sales Department.

Looking at the numbers alone, top management would conclude that the Sales Department has been doing exemplary work. Meanwhile, the Purchasing and Production Department needs to improve its performance. But it's crucial not to rely on variances alone but to investigate why.

For instance, most people had to stay at home because of lockdowns and cleaning became crucial to avoid the spread of the virus. Even without active effort, company sales can increase. But other departments would struggle due to lockdowns, delays in the arrival of materials, and lack of workers. Without adjusting variances the Sales manager who slacks off could be rewarded for stellar performance. Meanwhile, the performance of Procurement and Production managers who could not hit targets but are doing well despite adverse market conditions would be considered poor.

As noted by (Franco-Santos and Bourne, 2008) users should perceive performance measures to be fair. Any context where performance measures favor others should be avoided. By considering these trends and the current market landscape, the company could put effective systems back in place.

Industry Performance May Be a More Relevant Gauge of Performance

Most variances rely on historical data. But internal information based on historical figures would be outdated due to the impact of the pandemic. At this time, industry benchmarks and averages may be a better gauge of performance. Rather than focusing on variances based on last year's performance or the budget, it may be time to put more weight on variances between comparable companies in the industry.

By looking at how the company is fairing compared to other businesses of the same size, market, and industry, it would be easier to assess whether managers are doing their job effectively. This strategy could work when it's beyond the company's resources to come up with new standard costs.

With outdated standard costs managers committing theft and fraud could be harder since there's too much discrepancy between actual costs and budgeted costs. While it may not be the best measure, industry averages could help you assess a manager's performance so it's easier to identify red flags and irregularities in the system.

Identifying Controllable Variances

Segmenting variances as controllable and uncontrollable (Aruomoaghe and Agbo, 2013) would be one way to appraise a manager's performance during this time. This way, managers would feel more motivated to work towards a goal that is within their control.

With the current situation, operational variances which are based on the current situation could be a better measure of performance than planning variances based on historical projections. For XLG, in this case, operational variances would continue to be relevant for the company since it was able to set new standard costs.

As a company that maintains its competitive advantage for producing a superior product, XLG needs to maintain its reputation for being the best brand.

If management push employees to meet unrealistic goals, the company may face quality issues that could hurt sales and brand loyalty.

It's also worth noting that variance reports that are too idealistic or haphazard could hurt motivation. At least for the period, the better way to assess performances may not be variances but how well the unit performed despite the current situation. Hence, there should be emphasis that unfavorable variances are acceptable within reason.

Focus on Long Term Goals

Without targets to measure a manager's performance, it could be difficult to put controls in place and assess whether a manager is effective or not.

It's important to emphasize that variances which are crucial in planning and prices are part of long-term decision making to maintain a strategic business outlook (Weetman, 2011).

Variances will continue to be a powerful tool to make informed decisions. However, the company should not focus on pushing people to aim for a favorable variance.

Favorable variances are not always good. In fact, fear of having unfavorable variances could hinder managers and employers from proposing better strategies and taking advantage of opportunities. Hence, the top management should emphasize that the company's long term health and survival has more weight than variance reports.

With this in mind, the company should put equal weight on financial and non-financial measures to make better decisions for the company and to identify top performing managers.

Make or Buy Decision

During the second quarter of 2020, XLG Company struggled with procuring famaQ, the key component of its two products X and Y. FamaQ is a patented component which is currently produced in Brazil. This raw material provides the greatest competitive advantage for the company.

XLG sells its products online and in several stores across the country. Due to the increased demand for home cleaning products, it was one of the few companies that saw an increase in sales despite the economic downturn.

In Q2, total actual sales for both products X and Y were 1,600 units which are higher by about 50% compared to forecasted sales of 1,190 units. Based on the market outlook, demand for products would continue to see an increase of about 45%. However, with the situation around the globe, the company is considering the proposal to make its patented component, famaQ, in-house.

Based on the latest information available, producing famaQ in-house would cost £3 while importing the product from Brazil is estimated to cost £4.50.

	Make		Buy
	Product X	Product Y	

Original Standard Contribution Margin*	£25	£20	£4.50
Add: Revised Standard Material Cost/ Unit	£4.50	£4.50	
Sum	£29.50	£24.50	
Less: Cost of Producing famaQ in house	£3	£3	
Standard Contribution Margin Based on New Standard Cost	£26.50	£21.50	
*Assuming that the given contribution margin indicated has been revised to reflect the new standard material cost of £4.50.			

Based on the calculations above, producing the famaQ inhouse would be more cost-effective.

Before the pandemic, XLG's decision to import famaQ rather than produce it in house, like most companies, is due to cost savings. It was ideal to import famaQ at £2.50 than produce it in-house for £3. But with the disruption in the supply chain and the logistic challenges, producing famaQ in-house is a viable solution to improve XLG's production process.

In addition to cost savings, making the product in-house is recommended due to the following reasons:

- Normal production in the famaQ supplier in Brazil may not resume soon. As the hardest-hit country in Latin America and with the second-highest infection rate in the world (Horton, 2020), travel and export restrictions could continue to drive freight costs up in the country. Delays in receiving the raw materials due to force majeure for Products X and Y could also harm XLG's ability to meet increased customer demand. With the current situation in Brazil, there's also a high risk that the company supplying famaQ may not be able to meet production demand due to lockdowns or a decrease in workers who can report for work.
- During the first wave of the pandemic, XLG had to pay premium prices for raw materials due to limited transportation options. Since famaQ is a patented material, XLG has no alternate suppliers. Due to its reliance on the imported component from Brazil, it has no other option but to pay premium prices to continue producing products X and Y. This poses a big risk to any business which makes it crucial to look for alternate sites that could produce the required component (Choi, Rogers and Vakil, 2020).
- By producing the product in house, the company will have more wiggle room if disruptive events happen in the future. Producing the component on-site reduces the delivery time to 15 working days which would speed up production to keep up with the demand. A shortened supply chain is less likely to cause extended production disruptions provided that the in house factory meets the production demand.

While there are major advantages in producing famaQ in house, it's also crucial to look into the following:

- How long it takes to start producing famaQ on-site and the availability of facilities and manpower required to start production of the raw material for products X and Y.

- The ability of the in-house factory to maintain the quality of famaQ which is the key component of the company's cleaning products. FamaQ provides a competitive advantage for the company, so it's crucial to maintain or better yet improve this component.
- Company's access to local multiple suppliers of raw materials and possible changes in the availability of the raw materials needed to produce famaQ.
- Alternate use of production facility for famaQ. The pandemic would end and when the market starts to stabilize, it's possible for importing materials to be more cost-effective than in-house production.

With the uncertainties brought by the pandemic, it's crucial to consider the global scenario in corporate planning. Producing famaQ in-house is recommended but a more thorough review is required to assess the impact of this decision on the company's long term goals and performance.

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