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Accounting Fundamentals-LCBB4001

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(Assignment 2)

“In submitting this work, I affirm that my work adheres to the scholarly and intellectual standards of honesty and integrity. I affirm that this work is my work only and that in the preparation of this work I have not consulted any person. I affirm that I have not plagiarised or misrepresented the ideas or language of someone else as my own and that I have fully and accurately attributed any ideas or text of others to the sources and documented each source”.

1.a)

Contribution per unit=Selling price per unit-Variable cost per unit

Contribution per unit= £11- £6= £5

Break-even point (units)=Fixed cost/contribution per unit= £350,000/£5= £70,000

Break-even point (revenue)=Fixed cost/Contribution Margin Ratio= (Fixed cost x sales/ (sales-variable cost) = (£350,000x £825,000)/ (£825,000- £450,000) = £770,000

Revenue: £11x £75,000= £825,000

Variable cost= £6x £75,000= £450,000

b).

Profit= (£75000- £70,000) x £5= £25,000

c).

New selling price £13

New variable cost £6+ £1= £7

New contribution £13- £7= £6

New fixed cost $\text{£}350,000 + \text{£}10,000 = \text{£}360,000$

New sales volume = $\text{£}80,000$

New Break-even point $\text{£}360,000 / \text{£}6 = \text{£}60,000$ units

Profit $(\text{£}80,000 - \text{£}60,000) \times \text{£}6 = \text{£}120,000$

d). Limitations of break-even analysis:

Break-even point frameworks are significant controlling and planning tools connected to the development of the decision of the company. When the business does not make any profit or loss is called break-even point. Break-even point is important for profit making. Therefore, for any business to make money is important to sell the product at the right price. Break-even point is very useful business management tool, but it does have its limitation. The very first limitation with break-even analysis is the fact that is based on predicted data, not actual data. For example, if the forecast sales are not as predicted then your analysis is going to be undermined and it will not be as effective. Another limitation is going to be the effect of your competitors. If new business is open and selling the same product as yours or similar that could really affect the break-even analysis and make it less reliable or invalid. Limitation is if you have promotional offers which then affect the number of sales or the output you must achieve. If your suppliers decide to put up their prices, then your variable cost changes. That makes the analysis less reliable or may be affected negatively. Another limitation of break-even point analysis is if you change your prices. For example, if you put your prices up, sometimes lead to a fall in sales which means that the break-even analysis is not reliable. (Katsina C. Bala, 2007)

However, there are advantages of break-even analysis. Benefit planning is a very powerful method in the hands of management.

The higher the break-even rate, the lower the probability of a profit-driven company over the years. When conducting a break-even analysis, companies can easily recognise and include costs that are either left out or overlooked. Break-even analysis offers a straightforward image of the amount of products sold or the amount of profit to be produced to cover costs and achieve profit. Such statistics set a goal for the lower levels to be carried out effectively.

Another advantage of break-even point is it allows organisations to manage the fixed cost of the project.

2.a) Management accounting is different from financial accounting. Management accountants collect financial information mainly for internal use. Financial accountants report information used by external stakeholders. In comparison to financial accounting, management accounting does not follow the accounting principles. Management accountant reports include efficiency, planning and costs. In highly competitive and fast-paced business environments where rapid decisions need to be made, management accounting is extremely efficient. Such decisions may have to try to do with a tactic of pricing, budgeting, or revenue management. Managerial accounting will use operational data to quickly form a sense of matters. The aim is to use the budget to help make tactical decisions in the short term. (Dyson, John R. 2010)

In order to achieve its objectives, management accounting uses both financial and non-financial information. The need for non-financial management information in order to better manage and control the activities of the organization in the context of globalization is growing. Measuring and presenting it is quite a difficult task for managing accountants. The inclusion of non-financial information in the compiled management accounting information is important both for achieving the long-term goals of the organization and for its

operational management. If a comparative analysis is made between the qualities of the information created as a result of the functioning of the financial accounting system and the management accounting system, the following is observed:

- The information created by financial accounting is for general purposes - i.e. it is created in order to meet the needs of external consumers for information about the company. This information is officially disclosed, but is very general. Sometimes it is used to obscure certain economic phenomena, events or facts. Therefore, it cannot be applied to satisfy the information needs of the management, because "the financial statements, which generally present the property and financial condition and the results of the activity of the enterprises, reduce their usefulness.
- Unlike information created by financial accounting, information created by management accounting does not have to be measured and presented using the monetary measure. This also expands the possibilities for its use. In addition, management accounting information may not be as accurate as that created by financial accounting. For management accounting, the accuracy of the information is not the main goal, as the rule is that it is more important to receive it in time from the respective management entity than to be completely accurate, therefore a deviation is allowed in this regard.

b.) Techniques in management accounting:

- Break-even analysis

According to Artrill et al (2017), cost is the quantity sacrificed to accomplish a certain business goal. The term cost refers to the value of expenditure on raw materials, machinery, supplies, utilities, labour, goods, etc. This is the sum that is reported as an expense in

the financial reporting. For every business there are different types of cost:

- Fixed cost include any expenses that a company pays, which remains the same. It is the amount that a business must pay in order to stay operational. Usually, the fixed cost does not change over time and are used to assess the break-even point for companies.

Examples of fixed cost include rent, salaries, insurance. However, fixed cost can change if the cost of operation changes. For example, if the rent goes up, the fixed cost might be re-evaluated.

- The reverse of fixed cost is variable cost. When it comes to manufacturing and supplying good and services, variable cost have the most financial effect on a business. Such costs happen because of the procurement, distribution and handling of raw materials. As these can often include special terminology, variable costs are included in the final sum. Example of the variable cost are raw material cost, advertising and publicity, shipping changes e.g. According to Atrill et al (2017), in some cases, particular cost has an element of both fixed and variable cost. This is described as semi-fixed (semi-variable) cost.

- In the final step of the product or service, direct cost is also important factor to be addressed. Direct costs must provide the amount of time and effort dedicated to the development of the product or the hours of work that are spend into development. Examples of direct cost are direct labour, direct materials, fuel or power consumption e.g.

- The relevant cost- cost which refers only to a specific management decision and will be adjusted in the future as a result of that decision. The relevant cost is divided into future cost and opportunity cost.

- Irrelevant cost is cost that cannot be changed and there for should not be considered when making a decision. Sunk cost or cost that already have been paid are irrelevant. Committed cost of future cost

is irrelevant. Example of irrelevant cost could be the money that company spend to buy new equipment, advertising expenses, taxes paid by the company e.g. However, when advertising of that same product comes as a business decision, then the salary of the advertising campaign becomes relevant.

The break-even point is the point at which the profits of a corporation equal to its expenses. To measure the break-even point is to decide the number of units that need to be delivered, or the number of sales that need to occur in dollars or other currency.

- **Budgeting** – According to Jae K.Shim et al (2005) a budget is based on a detailed representation of plans, goals, and objectives of management that encompasses all areas of operations for a designated time period. The budget is an instrument that provides goals and direction. Budgets provide control over the immediate environment, help to master the job and department's financial aspects, and solve issues before they happen. Budgets concentrate on the significance of evaluation of different alternatives before decisions are enforced. There are different methods of budgets: incremental, program budget, supplemental budget, bracket budget e.g.

Budgeting process defines strategic objectives, allocates money, offers feedback, and motivate employees. The budgetary method should be standardised using budget handbooks, budget forms, and structured procedures. In the budgeting process, there are six steps: objectives, available resources, negotiating to estimate components of the budget, components organising and evaluating, trying to obtain definite approval, delivering the expenditure approved.

- **Capital Investment Appraisal**

Organizational management decisions on which ventures or assets to invest in and how to fund them to accomplish organizational goals are concerned with capital budgeting or investment assessment. This was described as a routine part of the budgetary control system as the background to this field of management accounting, hence the name 'capital budgeting' still used in many texts and organizations. The principles of economics have historically been applied to asset replacement and expansion decisions through investment valuation techniques, largely ignoring the larger sense of strategy development and implementation; therefore, non-financial considerations and risk levels have not always been completely evaluated. (Dyson, John R. 2010)

The methods of capital investment appraisal used to assess a business project's capital investment appraisal include: accounting rate of return, net present value, internal rate of return, profitability index, payback period, real options analysis.

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