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Assignment 2- Report

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Table of Contents

1. Introduction	3
2. Part A. Control Reports and Variance Calculations.....	3
2.1 Prepare the monthly control report showing original budget, flexed budget, and variances.....	3
Table 1: Control report and variance.....	4
2.2 Report on Amana's Performance during the Year 2020.....	4
2.3. Recommendations to Amana's CEO on Areas of Improvement.....	6
3. Part B: Evaluate Decisions using Relevant Costing.....	7
3.1 Cost Implications.....	8
Table 2: Cost analysis of alternatives.....	8
3.2 Cost-benefit analysis.....	8
3.3 Analysis of non-monetary costs	9
4. Conclusion.....	11
References List.....	12

Managerial Accounting for Amana Limited

1. Introduction

Budgeting for business activities is one of the most essential roles of management accounting. The objective of budgeting is to ensure that funds are available for business activities. To that end, managers have the choice of two budgeting methods namely fixed or static budget and flexible budgets. A fixed budget provides forecasts of revenues and expenses over a specific period without the budgetary allocations in line with business activities. The implication is that a company can be constrained in meeting the market demand when the business activities exceed the budgetary provisions. On the other hand, a flexible budget provides headroom for adjusting expenses, selling price, and units of production in response to market activities (Seal and et al, 2015, pp 548-554). Although this budgetary method is ideal because it respond to market dynamics, it causes variance between the actual and flexible budgets that can favourable or unfavourable. The following is a review of budget variances for Amana Limited followed by a review of the merits of different methods of streamlining business activities for the company.

2. Part A. Control Reports and Variance Calculations

2.1 Prepare the monthly control report showing original budget, flexed budget, and variances

The following table presents the control report containing the variance calculations. The variances for the various lines reflect the difference between the actual budget and the fixed budget.

Table 1: Control report and variance

Items	Cost per unit	Original (£)	Flexed (£)	Actual (£)	Variance	
Units		100,000	80,000	80,000		
Selling price	25	25	25	20	5	Unfavourable
Revenue		2,500,000	2,000,000	1,600,000	400,000	Unfavourable
Variable costs						
Materials	2.5	250,000	200,000	280,000	- 80,000	Unfavourable
Labour	4	400,000	320,000	440,000	- 120,000	Unfavourable
Overhead	1.5	150,000	120,000	120,000	0	
Contribution	17	1,700,000	1,360,000	760,000	600,000	Unfavourable
Fixed costs						
Warehouse rental	200,000	200,000	200,000	170,000	30,000	Favourable
Insurance	100,000	100,000	100,000	100,000	0	
Fulltime warehouse supervisor salary	50,000	50,000	50,000	35,000	15,000	Favourable
Profit		1,350,000	1,010,000	455,000	555,000	Unfavourable

2.2 Report on Amana's Performance during the Year 2020

The control report is critical in analysis Amana's performance for the 2020 financial year. Specifically, the designation of a variance as either favourable or unfavourable exposes positive or negative operations decisions for the company. In this case, several observations can be made. First, the company reduced the selling price because of Corona virus pandemic to enhance and increase in revenue. The original budget outlined a selling price of £25 per

unit but the flexible budget shows that the actual selling price was £20, creating an unfavourable variance of £5. This strategy is not sustainable primarily because lowering the price of a product without a corresponding increase in the volume of sales erodes a company's profitability (Alegre and Sard, 2017). Indeed, Amana's volume of sales decline from the budgeted 100,000 units to actual 80,000 units generating actual revenue of £1.6 million compared to the flexed revenue of £2 million, ultimately leading to an unfavourable revenue variance of £400,000. The implication, therefore, is that reducing the selling price is not a sustainable competitive strategy.

Another element in the control report is operating expenses including three variables namely materials, labour, and overheads. A review of the variance for the three lines shows that the management decisions led to unfavourable variances. For example, the budget for materials increased from the flexed amount of £200,000 to £280,000, creating an unfavourable variance of £80,000. The business decision to increase the volume of materials without a corresponding increase in revenue is not sustainable and is likely to erode the company's profitability. Similarly, increasing labour expenses to the effect of an unfavourable variance of £120,000 is a flawed managerial decision that is likely to deprive budgetary allocation to other key departments such as research and development (Weustink et al., 2000). In the era of increased competition, companies are increasingly mainstreaming technology to reduce the cost of raw materials and labour. The fact that these variables are increasing for Amana Limited points to an unsustainable business strategy.

The incremental profit contribution is a measure of a company's efficiency in generating revenue and optimising variable expenses. An increase in incremental profit shows that a company has adopted plausible managerial measures. However, this is not the case of Amana Limited as evidenced by an unfavourable variance in the contribution variable of £600,000. The flexed contribution for Amana is \$1.36 million derived from a contribution

per unit of £17. In contrast, the actual contribution is £760,000, yielding a variance of £600,000. This trend is not sustainable, especially with the increase in the operating expense such as labour and materials (Weustink et al., 2000). The ideal situation is for the increased expenditure in operating expenses to manifest in an increase in incremental profit.

Despite the unfavourable variances in most of the variables in Amana's budget review, the company has employed positive managerial decision in several other aspects. Specifically, there is a favourable variance in warehouse rental and full-time warehouse supervisor salary. This decision is sustainable and is likely to enhance the company's competitiveness in the pricing of its products. For the 2020 financial year, Amana Limited's variance between the actual and flexed budget was £30,000 and £15,000 for warehouse rental and full time supervisor salary respectively. The deduction is that the company has optimised its warehousing strategy. The possible explanations is that the company has reduced the number of warehouses or there is an efficient supply chain management system whereby a part of warehousing expenses are shifted to other stakeholders in the supply chain (Soin and Collier, 2013). The strategy should be maintained because it improves the operating efficiency, thereby reducing expenses.

2.3. Recommendations to Amana's CEO on Areas of Improvement

The control report and the subsequent analysis of Amana's performance in the 2020 financial year show that there Amana's management, specifically the CEO need to institute some improvement measures.

The company should reverse the decision to lower the selling price. Amana's profit margins have been positive for the preceding years as evidenced by the contribution of £17 per unit from a selling price of £25. In the wake of COVID-19 and reduced travel by tourists, it is expected that the company would experience a deterioration in profitability. However, lowering the selling price is likely to affect the company's profit margins and impair its

ability to make investments for future growth (Rohde and Garrison, 2019). Therefore, the company should maintain its selling price and consider other cost-saving measures to improve efficiency.

Amana Limited should optimise the cost of materials. The survival of the company and its ability to meet the needs of the customers is material-intensive, implying that the cost of materials will continue to be one of the primary costs for Amana capital in the future. Consequently, the trend of the increase in the cost of raw materials should be reversed to optimise operating expenses (Rohde and Garrison, 2019). One of the solutions is to find an alternative supplier for souvenirs because this is one of the primary ingredients for Amana's products. To this end, the company can explore domestic and international suppliers.

The company should optimise labour expenses to remain competitive. Labour is an inherent expenses for virtually all companies including Amana capital. However, in the wake of increased technology, Amana capital needs to mainstream technology in the production process to improve operating efficiency and lower wages and expenses. A plausible alternative for the company to achieve this outcome would to engage in business process outsourcing (Rohde and Garrison, 2019). In this case, the company can outsource the production of its products to countries or regions with low labour expenses.

3. Part B: Evaluate Decisions using Relevant Costing

Amana Limited has two options namely creating an individual online sales and supply system or selling directly at Amazon. Each of these alternatives has unique costs implications. Therefore, recommendation and the eventual decision by the company on the ideal course of streamlining business activities should consider all these costs as presented below. The recommended course for the company is to set up their own online shop.

3.1 Cost Implications

The following table summarises the various costs incidental to each alternative. The objective is to compare the costs against the expected benefits resulting from the guaranteed sales. Notably, the calculations are made under the assumption of a selling price of 25.

Table 2: Cost analysis of alternatives

Establishing an Individual Online Network Cost		Selling at Amazon Cost	
		Amazon Fulfilment Fees	
Delivery network	£150,000		£50,000
Upgrading website	£50,000		
Salary of IT programmer	£35,000		
Total costs	£235,000		£50,000
Benefits			
Guaranteed sales	100000		65000
Selling price	25		25
Revenue	£2,500,000		£1,625,000
Net benefits	£2,265,000		£1,575,000

Based solely on the cost analysis, the best strategy for Amana Limited would be to embrace the alternative of selling at Amazon. This choice is associated with a single cost element of the Amazon fulfilment fee of £50,000. In contrast, establishing an individual online sales and delivery network would have several costs including the cost of creating a delivery network, upgrading the website, salary of IT managers, all of which accumulate to £235,000. Based on this analysis, selling at Amazon would be the best alternative. However, it is important to note that the cost analysis is not conclusive. Therefore, this recommendation needs to be subjected to other elements of each alternative.

3.2 Cost-benefit analysis

The primary goal of strategic decision by a company is to become competitive. Improved competitive edge is manifested in increased sales and revenue. Therefore, besides the cost implications, it is important to mainstream, the benefits in the analysis (Srisruthi,

2017). Creating an individual online network guarantees sales of 100,000 units annually, whereas selling at Amazon guarantees sales of 65,000 annually. Assuming that the company would maintain its budgeted selling price at £25 per unit, selling at the company's website would generate £2.265 million in annual revenue compared £1.575 million in annual revenue when selling at Amazon. Therefore, selling at the company's website would generate excess revenue of £690,000.

The agency theory of management proposes an agency relationship between the managers of a company and the shareholders. Under this relationship, the managers are supposed to act as agents for the shareholders by making decisions that maximise the value of the firm (Evans and Tourish, 2016). From a managerial accounting perspective, the implication is that managers should evaluate decisions based on their costs and benefits and implement the decisions that maximise benefits. Consequently, it is plausible to contend that selling through an individual online network would generate more value for the company as evidenced by the excess net benefits of £690,000 for the individual network compared to selling at Amazon.

A unique element about the incidental costs is that in both cases, a majority of the costs are fixed the salary of a fulltime IT programmer. The implication is that the cost of setting a fully-owned system for Amana Limited is not prohibitive because they would not recur in the subsequent years of operations.

3.3 Analysis of non-monetary costs

Economic and managerial decisions are associated with opportunity costs. Managers are confronted with different alternatives, each with unique opportunity costs, some of which cannot be quantified in monetary value. The case of Amana presents a classic example of opportunity cost. For example, choosing to sell directly at Amazon would be associated with loss of control over pricing and return policy. In effect, the company's profitability would be

impaired because of the separation between the various elements of the company's supply chain. Specifically, the pricing of the products would be separated from the production processes meaning that it would be impossible to forecast revenue with relatively fair consistency (Alegre and Sard, 2017). Notably, Amazon harmonised the return policy for all the companies in the platform. This would deprive Amana of the capacity to improve the relationship with the customers, impairing the potential to improve sales.

Selling at Amazon is associated with high level competition from other companies selling souvenirs. The completion is likely to impair the ability of Amana Limited to customise its marketing plan to meet the needs of different classes of customers in the market. In contrast, when selling at the company's website the company can embrace customised marketing plan including product differentiation to connect directly with the customers. Goodwill is an important intangible asset for a company. For a company to improve the valuation of its goodwill, it needs to connect directly with the customers (Alquwayfili, 2017). This opportunity would only be provided by selling directly to the customers at the website as opposed to selling at Amazon. Indeed, selling at Amazon makes it difficult to establish a personal connection with the customers.

Establishing an individual online store would give Amana flexibility in pricing and the ability to control other players in the supply chain. These are important factors in helping the company optimise its costs. In contrast, selling at Amazon would imply that the company has not control over supply chain players including distributors and retailers. This can hamper the company's ability to responds to concerns from customers (De Toni et al., 2017). Similarly, pricing at Amazon would be dependent on competitive force such that all companies with similar products would become price takers. An individual online shop would help the company overcome this shortcoming.

4. Conclusion

The discussion exposes the important of budgeting for managerial accounting. Acknowledging the fact that the market has become increasingly competitive, it is notable that a flexible budget is ideal because it enhances the company to respond to changes in activities. However, it is important to manage the variances between the actual and flexed budget to ensure that they improve the company's favourable. The control report for Amana Limited exposes positive management of specific items including fixed expenses and selling price. It also exposes the fact that specific lines items such as variables costs have increase from their budgeted values, in effect impairing the company's revenue. The recommendations are the company to reverse the change in selling price, and optimise labour and material expenses. Concerning the choice between opening an individual online shop and selling at Amazon, the cost analysis shows that the plausible choice is to open an individual online shop.

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