

Finance

MODULE: LCBB 5002

Student number: 1815963

Student name: Naomi Rahela Bozianu

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Introduction:

The purpose of this report is to identify what is the variance analysis and how it is important in the businesses. This report will improve the understanding regarding the use of the variance analysis and how it is computed for different measures. In addition to this, the merits and demerits will be assessed in the context of variance analysis in XLG and in the efficiency of the managers. It will furthermore investigate and analyze two options such as buying and purchasing FamaQ and then will provide suggestions about the selection of options.

Part A:

Sales Variance:

Variance is the gap between the actual figures related to the performance and budgeted measures and performance. The analysis of the variance may be a critical tool to find and define the deviation in the measures and performance that can lead effectively in the management of the entity. The variance may be measured in positive as well as a negative form. The positive deviation is referred to as the variance occurring when actual performance exceeds estimated and budgeted and vice versa. Sale variance is one of the important types and measures of variance in the entity for determining the efficiency in management for attaining the goals of the increase in sales (Hornngren et al., 2002). The capability of the entities might be assessed using this variance whether it is able to increase the sales or not. The sales volume and sales price variance are two kinds of sales variance.

From the given scenario,

Chemicals	X	Y
Budgeted Sales volume	595	595
Actual sales volume	850	750
Standard Price	£35	£30
Actual Sales price	£45	£37
Standard Margin	£25	£20

Sales price variance:

This measure is applicable in the entities for examining and evaluating how the actual price is different from the standard price of the goods. The market change and change in the environment may cause fluctuation in the actual price. It can be lowered or increased in the future based on the circumstances (Kinney and Raiborn, 2011). This variance may be computed by applying the formula given below:

$$SPV = (\text{Actual Price} - \text{Standard price}) * \text{Actual volume of sales}$$

Hence,

Description	Actual Price (£)	Standard Price (£)	Difference (£)	Actual Volume	Sale price variance (£)
Chemical X	45	35	10	850	£8500
Chemical Y	37	30	7	750	£5250

From the analysis, it can be stated that the actual sales price of the items and chemicals of XLG is higher than the budgeted and standard price. This is a positive variance and deviation may indicate growth in sales.

Sales volume contribution variance:

This deviation is applied for assessing the change in the profit and volume contribution of the enterprise. This is very important for analyzing the deviation in the volume contribution and for examining the efficiency and effectiveness in the enterprises (Horngren et al., 2002). This deviation might be determined by applying the formula:

$$(\text{Actual sales volume} - \text{Budgeted Sales Volume}) * \text{Standard margin}$$

Hence,

Description	Actual sales volume (Units)	Budgeted sales volume (Units)	Difference (Units)	Standard margin (£)	Sales volume contribution variance (£)
Chemical X	850	595	255	25	£6375 (F)
Chemical Y	750	595	155	20	£3100 (F)

The variance for the two chemicals is positive because the actual units of sales are higher than the budgeted and anticipated sales volume for each chemical in XLG.

Material Variance:

Material is the input in the production of the goods or services. FamaQ is material that is used in the production of Chemical X and Chemical Y in XLG and the material variance would aid to determine the deviation in the material use and prices in the company (Drury, 2013). The management efficiency in the XLG might be analyzed by considering this measure in the company.

Chemicals	X	Y
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Original standard price	£2.50 per unit	£2.50 per Unit
Revised price	£4.50	£4.50
Actual paid	£3.70	£3.70
Sales volume	850	750
Unit of Fama Q for one unit of a chemical	1	1

The variance of material price planning:

It is a very effective and important measure for assessing the variance and it may provide feedback to managers how they are performing effectively in the XLG for making decisions regarding the prices of the items (Drury, 2013).

(Original target price-general market price while purchasing) *quantity purchased

Hence,

X	Y
$(2.50-4.50) * 850 * 1$ = -£1600(A)	$(2.50-4.50) * 750 * 1$ = -£1500 (A)

From the variance and deviation identified for chemical X and chemical Y, it can be stated that the variance is negative as the revised and general market price of the Fama Q at the time when the material was being purchased by XLG.

The variance of material price operational:

(Revised standards price-Paid price) *Actual units purchased (Drury, 2013)

Hence,

X	Y
$(4.50-3.70) * 850 * 1$ = £680 Favorable	$(4.50-3.70) * 750 * 1$ = £600 favorable

This variance is favorable	This variance is favorable
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Merits and Demerits of Variance analysis:

Variance evaluation and analysis is one of the most useful and effective tools of MA which is used in planning and controlling the performance of enterprises. The decisions can be changed, and the strategies of the firm can be revised based on the results of variance analysis to minimize the negative variance and ensure effectiveness in the strategies and capabilities.

Merits or advantage of the variance:

The managers in the companies use the variance analysis for making decisions regarding the purchase and sales to get the objective of the entity to balance the performance of the company. The planning of the tasks and development of the actions along with the allocation of the duties and responsibilities to the delegated person can be determined using the variance analysis (Horngren et al., 2015). Production managers, for example, are provided with the responsibility to manage the deviation and to manage the variance in the material. They can plan and manage the production by using variance analysis.

This is an important method and tool for curbing the variance in sales and performance. For instance, the sales of Chemical X as well as Chemical Y increased over the budgeted sales volume in the XLG. The growth in the demand for the products or services in the market has resulted in an increase in the sales of the Chemicals of XLG. The manager had to purchase more material than budgeted for the company. Hence, this method aid to measure the efficiency of the respective managers in the company how they manage the performance. The positive variance of the sales in the company is indicating higher efficiency in strategies of the managers working in XLG (Bai, 2016). An unfavorable variance may reveal the inefficiency in the management of the entity.

Along with this, the managers would be more able in XLC to forecast and thing foreword to attain the goals. The variance measure can be the use for the marketing, production, purchase, and other managers to determine whether the volume of the products is more or less than budgeted, the cost of operation is more or less than budgeted and others. This may aid to forecast to manage and control the progress (Heong et al., 2013). The purchase manager realized the general price of the

material is more than the standard price, but the manager efficiently compromised with suppliers in the market.

The competitive benefits may be attained by using these methods and techniques. The improvement and revision of the strategies as per the situation may enable the firms to gain a competitive benefit. Regular variance analysis may enable the manager to find mistakes and determine issues in their strategies so that they can improve the strategies by putting rational concepts in the decision (Kaplan and Atkinson, 2015). It may be applied by the manager as the control mechanism as it allows the comparison of actual figures with budgeted so that issues can be determined based on the deviation in performance.

Demerits or disadvantage of variance analysis:

There are some disadvantages of the variance analysis may affect the use of this technique in the organizations. The past performance and figure are considered by the accounting manager and staff to set the comparison between the actual productivity and performance with the anticipated but this technique is not effective and useful for the managers in the company during the current year. XLG managers may need sufficient information about the current performance of the strategies to measure the effectiveness and to determine the effects of change in the environment on the progress and variance (Drury, 2013). However, variance analysis cannot be used frequently as it is used at the end of the year, but managers may require faster the information which is not possible through this method. It may affect the effectiveness of the technique.

Along with this, variance analysis may encourage the managers in the firms to reduce the material variance and cost of the material or operation. The manager may resort to the purchase of the cheaper material for cutting down the prices of the material. Cheaper material may cause a compromise in the quality of the products or services and this may lead influence on the sales and performance (Bai, 2016). In addition to this, it is easy to determine the variance in the performance, but it is very hard to determine and identify the causes of the variance in the performance.

Managers may generally manipulate the measures of the variance to get favorable results and to attract clients and investors (Heong et al., 2013). This may influence the efficiency in the operation and may influence the decision of the stakeholder accordingly. Managers may use incorrect measures for assessing and determining the variance in the activities and measures. A detailed

investigation is needed after using the variance analysis and this technique is not complete until the investigation (Kaplan and Atkinson, 2015).

Part B:

XLG is producing two Chemicals and it uses FamaQ material for producing the chemicals. This is unique for the company and it is leading the quality and uniqueness in the chemicals in the UK. XLG is gaining competitive benefits based on the uniqueness of the products and this is growing the sales and income of the entity in the market. Currently, it is importing FamaQ from Brazil to produce the products. The firm is facing issues in the acquisition of material due to the increased prices of the material in the market. XLG may face different risks associated with importing the Fama Q such as the risk of the quality, risk of currency fluctuation, risk of the higher transportation cost, and others. XLG can realize the influence of these risks in the quality of the products and the cost of the products which may affect the sales in the market. A higher delivery period may lead to more cost and dissatisfaction to consumers that may cause the loss of the consumers. Importing of the material does not provide control on quality to the XLG and this may lead to risk in the quality of material (Sillanpää, 2015). Manufacturing FamaQ would reduce these risks and would improve competitiveness by improving the supply chain and products. It may enable XLG for gaining competitive benefits by increasing consumer loyalty and others.

XLG conducted the research in the market that provided information that the demand in the market for Chemical X and Y has increased by 45% that may lead to good improvement in revenue and income. This may require the XLG to raise the quantity of the production for meeting the demand increase. The production may be increased by making sure the material is available in a significant quantity (Daneshgar et al., 2013). If the gap between the capacity of XLG to produce the chemical and the demand for the products is higher, this may enhance the cost of an opportunity to firm. Importing material may be delayed due to increased restrictions and others while manufacturing FamaQ would enable XLG to produce the material in a significant amount by ensuring the availability of the material in time (Andersson, 2011). Hence, XLG should manufacture FamaQ for gaining more benefits in terms of growth in sales and meeting demand.

The cost is also an important measure for assessing the cost associated with the options available to the company. Fama Q can be produced or can be imported by the firm. From the analysis, it is

found that the cost of manufacturing FamaQ is lesser than the cost of importing the material from the Brazil Suppliers. The cost of purchasing from the supplier is £4.50 while the cost of producing the material is £3 if it produces in the UK. This indicates that the XLG is quite efficient in producing the FamaQ at a lesser cost than the cost of material in the market. In addition to this, the cost of transporting FamaQ, importing duty, and other costs may add to the actual cost and price of the FamaQ. It means the manufacturing expenses and cost for FamaQ are cheaper in comparison to the purchase of this material and may ensure more effectiveness in the performance (Rosyidi et al., 2020). Production may generate the results as desired and this may create a positive variance by increasing the supply of the products in the market for meeting the demand. The risk in manufacturing is lesser than purchase as it may avoid the risk of price fluctuation, cost risk, and others.

In addition to this, the delivery may be the issue in the operation of the entity if the material is not supplied at the right time. If the Fama Q is imported from Brazil, it may lead to delay in the delivery of material by 15 days while the production of this material may increase the efficiency in the delivery by cutting the time of delivery by 15 days. It means manufacturing FamaQ is a good option to ensure the timely availability of the material to XLG to produce chemicals on time to fulfill demand in lesser time for growing consumer satisfaction (Andersson, 2011). Therefore, it can be recommended to XLG for selecting the alternative of producing FamaQ instead of purchasing the same material from Brazil.

Conclusion:

Based on analysis, it can be concluded that this study has effectively analyzed the variance analysis by using sales and material variance. Furthermore, this report has effectively investigated two options and suggested that XLG should manufacture the material in place of the purchase of material.

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