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LEVEL 4

LEFEL 4

EXAMINATION PERIOD
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MODULE CODE: LCBB4001
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ACCOUNTING FUNDAMENTALS

TIME: 9:00AM TO 4:00PM

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Date & Time : 27/08/2021; 09.40am

QUESTION 1

Kerrigan Ltd makes and sells product A. The current selling price is £11 and the total of variable costs per unit is £6. The fixed costs of production are £350,000 and the company currently sells 75,000 units.

Required:

- (a) Calculate the break-even point (in units and revenues) of product A for Kerrigan Ltd. [10 marks]

Product A	1 Unit	75,000 Units
Total Fixed Cost	£ 350,000	£ 350,000
Fixed Unit Cost	£ 350,000	£ 4,7 per unit
Variable Cost	£ 6	£ 450,000
Selling Price/Income	£ 11	£ 825,000
Profit after Costs	£ 0.34	£ 25,000

Product A	1 Unit	70,000 Units
Selling price	£ 11	£ 770,000
Variable cost	£ 6	£ 420,000
Contribution	£ 5	£ 350,000

Sales revenue = total costs; Contribution = fixed costs;
Breakeven point = Fixed costs/Contribution per unit = £350,000/ £5 = 70,000;
At the production of 70,000 units, breakeven point is achieved.

- (b) Calculate the profit made on sales of 75,000 units. [10 marks]

Profit = Total income – Fixed Cost – Total Variable Cost
Total income = selling price per unit x 75,000 units = £11 x 75,000 = £825,000
Fixed cost = £350,000
Total Variable Cost = variable cost per unit x 75,000 units = £6 x 75,000 = £450,000
Profit = £825,000 – £350,000 – £450,000 = £25,000

- (c) The company will make an advertising campaign costs £10,000 and will improve the product specifications, which will increase the variable cost per unit by £1. This is expected to allow the company to increase the selling price to £13 and the sales is expected to be 80,000 units. Calculate the new profit figure for the improved product. **[15 marks]**

Improved Product A	1 Unit	80,000 Units
Total Fixed Cost	£360,000	£360,000
Variable Cost	£7	£560,000
Selling Price/Income	£13	£1,040,000

Profit = Total income – Fixed Cost – Total Variable Cost

Total income = selling price per unit x 80,000 units = £13 x 80,000 = £1,040,000

Fixed cost = £360,000

Total Variable Cost = variable cost per unit x 80,000 units = £7 x 80,000 = £560,000

Profit = £1,040,000 – £360,000 – £560,000 = £120,000

- (d) Discuss the limitations of break-even analysis. **[15 marks]**

The limitations of break-even analysis include the assumption that variable costs increase at a steady rate in line with the activity, that most of the costs are variable, whereas in some areas of productivity that is not the case, that the analysis is centered on fixed numbers that are not correlated to external factors that might contribute to fluctuations in revenue (such as market fluctuations or crashes, competitions, demand of product and others). Thus, using the break-even analysis comes in handy for companies that produce one product at a steady rate, considering that production and costs are not highly affected by time, market changes and demand, or that these factors could be easily inputted into the analysis, so thus the calculations are accurate and up to date.

QUESTION 2

- (a) Discuss the importance of management accounting, and how it differs from what financial accounting provides. **[25 marks]**

Management accounting is a very important part of a company's scheme to success. It refers to a company's capability of implementing pre-established standards to meet and excel. Its main goal is to use various tools of managerial analysis to understand the performance of the company and where changes could be made for improvement. Efficiency is, in this case, stretched to the max and, by implementing means of managerial accounting, managers/heads of departments can then make sure demanded targets are met and resources are used to the fullest. On top of that, it eases the processes of management decisions, as it provides accurate views of capital budgeting, budgetary controls, marketing meets, quality standards, price controls and sufficient accurate data regarding market demands. Overall, management accounting is of uttermost importance in aiding managers to properly manage businesses by providing great reliability.

Whilst management accounting is created for bettering a company by giving managers sufficient financial information on overall operations, financial accounting is different in terms of approach, target, results and public.

A main difference between the two types of accounting mentioned above is that whilst managerial accounting can be modelled individually for each company, structured, and ruled by the company, the financial part of it needs to be strict, accurate and regulated, as they shall be published for external potential investors to review. The financial part follows unchangeable worldwide recognised rules when approaching stocks, revenues, and expenses, whereas the managerial part is highly flexible and can accept drastically changes for the better of the company.

As well, financial accounting is mainly appointed for external forces to look at, such as regulators, investors and so on, whereas management accounting is strictly created for managers to gain relevant view on overall performance and could be, if desired, highly classified, and not exposed to public. The financial accounting is important for disclosing a business' financial health and performance, whereas management accounting is important for creating a view of these aspects and aiding in discovering what improvements could be made.

(b) Discuss three techniques by which the management accountant can achieve the objectives of management accounting.

[25 marks]

The three chosen techniques by which the management accountant can achieve the objectives of management accounting to discuss are: 1.) margin analysis, 2.) capital budgeting and 3.) inventory valuation and product costing.

1. Margin Analysis

Margin Analysis is a tool used by companies to understand the maximum potential profits by analysing benefits and costs in comparison. This analysis is looking at one unit change in activity and produces estimates based on that change.

The idea behind margin analysis is that a company can have a clear view of profits whilst involving costs. It shows how an increased production can benefit and when the break-even point is met. Total expenditures and gross sales can determine the unit volume when being equalized and results in clear figures of how much a product should cost to meet demanded targets (may them be time targets or income targets). Production is, then, looked at from an optimization point of view. This technique is essential in having a brief understanding of expenses and incomes.

2. Capital Budgeting

This tool represents a gathering of required information for capital expenditures that helps managers make decisions on how to budget the capital. Using this, managers can calculate certain relevant aspects, such as internal return rates and net present value and providing real time information on relevant outputs, such as payback periods or accounting rates of return.

3. Inventory Valuation and Product Costing

By running processes of valuation of inventory and costing of product, a business could identify actual costs associated with goods and services. Costs of goods sold are evaluated by direct costs and overhead charges are allocated in order to meet real values given.

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