

University of Wales Trinity Saint David

BA (Hons) Business Management Level 4 - Weekend

Accounting Fundamentals LCBB4001– Lecturer: Dr Emad Elkhashen

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QUESTION 1

(a) Total of Variable Costs = £1.35 + £1.75 + £0.40 = £3.50

Contribution margin = £5.75 - £3.50 = £2.25

BEP units = £180,000 / £2.25 = 80,000 units

Revenues = 80,000 x £5.75 = £460,000

Gross margin = £2.25 / £5.75 = 0.39 (39%)

BEP revenues = £180,000 / 0.39 = £460,000

b) 90,000 units – 80,000 units = 10,000 units

Profit = 10,000 x £2.25 = £22,500

c) New total of Fixed Costs = £180,000 + £12,500 = £192,500

New Variable costs = £1.90 + £1.40 + £0.40 = £3.70

New Units sold = 90,000 + (90,000* 5%) = 94,500 units

Contribution margin = £6.00 - £3.70 = £2.30

BEP units = £192,500 / £2.30 = 83,696 units

New profit calculations:

94,500 units – 83,696 units = 10,804 units

New Profit = 10,804 x £2.30 = £24,849

(d) A break-even analysis is a useful tool for calculating at what point a company, or a new product or service, will be profitable. That is determining the number of products or services you need to sell to at least cover the incurred costs. Break-even analysis looks to be a very valuable and useful aid to decision making however it has some limitations that should be taken into consideration. Break-even works on the basis that all output is turned into sales revenue. In reality, firms will have stocks of unsold items at any one time, unless they can work on a purely just-in-time basis. Most businesses sell their products at different prices in different markets and to different customers. Break-even calculation ignores all economies of scale. The business world is dynamic and any increase in output and any change in costs is likely to impact on price levels. Break-even, like a balance sheet, is only a snapshot of a situation at a particular point. Increasing shortages of energy, for example, will result in some significant increases in both variable and fixed costs.

However, it also has some advantages such as predicting the level of risk in a start-up, measures the profit and loss at different levels of production and sales, analyzes the relationship between fixed and variable costs. Considering these limitations, the break-even analysis tool should be used more in planning and cautiously in the decision-making process.

QUESTION 2

(a) Management accounting identifies, measures, analyzes, and interprets financial information that is then communicated to managers. Some of the primary tasks or services performed by management accountants include: rate and volume analysis; business metrics development; price modeling; product profitability; cost analysis; capital budgeting; sales forecasting; financial forecasting; annual budgeting; cost allocation. Managers use this financial data and estimates in order to make well-informed operational decisions on the business progress. The type of decisions that managers make based on the management accounting data can be how much to sale function to the Break-Even Point (BEP), or function to the safety margins, etc. Also, some decisions are done based on capital appraisal; managers need to establish when/if to start a new line of production or open a new branch, because all these decisions should be made based on a cost analysis. Every decision implies incurring or committing costs. So, Management Accounting is important because it is an integral part of the management activity and while it provides information for managers, the financial accounting provides financial information to parties outside the organization. Financial accounting is highly regulated and the information it provides is not flexible as it has to conform to certain financial regulations and has to be made public. Because managerial accounting is not for external users, it can be modified to meet the needs of its intended users. Some company's departments may want the financial information displayed as a percentage of units produced in the period while the HR department manager may be interested in seeing a graph of salaries by employee over a period of time. Managerial accounting is able to meet the needs of both departments by offering information in whatever format is most beneficial to that specific need. So, Managerial Accounting is not externally regulated and can be done flexibly, function to each operational department's needs, providing a great level of detail while the accounting management provides a fixed set of information. Another important aspect when comparing the two types of accounting is the frequency – Statement of Financial Position is prepared quarterly and at the end of financial year while management accounting reports are generated regularly or function to business needs reflecting an accurate, updated financial information of the business. So, although we can get good information from Financial Accounting this is a limited amount of information -for example, from a statement of financial position we don't find out what are the variable costs as the costs of sales is presented with just one number – it is highly regulated and with limited flexibility.

(b) Management Accounting helps managers to apply the management functions by translating planning, organizing, leading, and controlling to different financial techniques. For example, when comparing the end of year budget with what was initially planned, managers will be able to understand where their business is at and what to do next. In the processes of planning organizing and decision-making managers use the fallowing techniques:

Financial Planning - the main objective of any business organization is maximization of profits. This objective is achieved by making proper or sound financial planning. Hence, financial planning is considered as best tool for achieving business objectives.

Cost Accounting - it presents cost data in product wise, process wise, department wise, branch wise and the like. These cost data are compared with predetermined one. This comparison of two costs enables the management to decide the reasons responsible for the difference between these costs.

Fund Flow Analysis – helps to find out the movement of fund from one period to another. Moreover, this analysis is very useful to know whether the fund is properly used or not in a year when compared to the previous year. The working capital changes and funds from operation are also find out through this analysis.

Cash Flow Analysis - the movement of cash from one period to another can be find out through this analysis. Besides, the reasons for cash balance and changes between two periods are also find out. It studies the cash from operation and the movement of cash in a period.

Standard Costing - predetermined cost. It provides a tool for measuring actual performance. It is used to find the reasons for the deviations if any.

Marginal Costing - is used to fix the selling price, selection of best sales mix, best use of scarce raw materials or resources, to take make or buy decision, acceptance or rejection of bulk order and foreign order and the like. This is based on the fixed cost, variable cost and contribution.

Budgetary Control - under Budgetary control techniques, future financial needs are estimated and arranged according to an orderly basis. It is used to control the financial performances of business concern. Business operations are directed in a desired direction.

Revaluation Accounting - the fixed assets are revalued as per the revaluation accounting method so that the capital is properly represented with the assets value. It helps to find out the fair return on capital employed.

Ratio Analysis - it is used by management in the discharge of its basic functions of forecasting, planning, coordination, communication, and control. It enhances the effective control of business operations by undertaking an appraisal of both the physical and monetary targets.