

Management Accounting

Assignment 2

Student name: Viktoriya Tancheva

Module code: LCBB5002

Lecture's name: Winifred Soribe

Student number:1814113

Table of Contents

INTRODUCTION.....	2
MAIN BODY.....	3
Computation of the Sales price variances and sales volume contribution variances:.....	3
Efficacious analysis of all major merits as-well-as demerits relating to the application of variances in assessing managers' performance:....	6
Part B.....	11
CONCLUSION.....	15
REFERENCES.....	16

INTRODUCTION

Under management accounting, managing personnel apply accounting information provisions to effectively comprehend themselves before determining matters within their organisations, which helps to manage and control effectively all functions and outcomes. Management accounting allows for effective reporting of the company's financial status with facts and information needed (Hutaibat and Alhatabat, 2019). It recognizes, tracks, analyses, interprets and incorporates information so an entity can achieve its objectives. This study comprises multiple aspects of directly or indirectly concerned with management accounting in context of provided case-study of XLG. A practical calculation of different variances is covered in report along

with vital advantages and demerits of variances in relation to the assessment of managerial performance. Moreover, this study helps to take decision whether to import FAMA Q or in-house the production of FAMA Q based on respective case-study.

MAIN BODY

Computation of the Sales price variances and sales volume contribution variances:

Sales Price Variance: It is the difference between actual and standard selling price. Change in the market condition is the main reason of such deviations. As product sold for lower price than anticipated than it reflects unfavourable result and if the price is higher than budgeted it shows favourable results.

Sales price variances

XLG case study provides following information as summarised below for calculation purpose:		
Overall units quantities sold:	1600 units	
Material price variance:	£27000 F	
Sales and Contribution:		
	Chemical : X	Chemical : Y
Budgeted aggregate sales	595 units	595 units
Actual volume of Sales	850 units	750 units
Sales price: (Standard)	£ 35	£ 30
Sales price: (Actual)	£ 45	£ 37
Standard profit margin	£ 25	£ 20

*Sales price variance = (Actual Price – Standard Price) * Actual Unit*

<u>Chemical : X</u>	
Sales Price Variance (X) =	$(45 - 35) * 850 = 8500F$
<u>Chemical : Y</u>	
Sales Price Variance (Y) =	$(37 - 30) * 750 = 5250F$

Sales Volume Contribution: This variance is calculated if a company operates under a standard marginal costing system by finding the difference between actual quantity of product sold with budgeted quantity and multiply the result with standard unit price. Sales Volume Contribution also help management to access adverse effect of such variance on performance.

Material Price Planning Variance: It indicates the difference between actual cost and standard cost. Actual cost is to be calculated by multiplying actual quantities with the actual price; and actual quantity is multiplied with standard price which results standard cost. This method helps to measure efficiency of purchasing department.

Material Price Operating Variance: To acquire material and labour both material price and usage variance can be analysed in operating variance. Total number of units purchased is multiplied with the difference between actual and budgeted cost under this method

Sales volume contribution variance = (Actual no. of units sold × Budgeted price per unit) – (budgeted number of units sold × Budgeted price per unit)

<u>Chemical X</u>	
Sales volume contribution variance (X) =	$(850 * 35) - (595 * 35) = 8925 \text{ F}$
<u>Chemical Y</u>	
Sales volume contribution variance (Y) =	$(750 * 30) - (595 * 30) = 4650 \text{ F}$

(ii). Computation of material price planning variance and material price operational variance:

XLG case study provides following information as summarised below for calculation purpose:	
Original standard price	£2.50 per-unit
Increased(revised) unit price	£4.50

Material price operational variance:		
<u>Chemicals X</u>		
(A) Original budgeted sales x Standard Margin =	$595 * 2.5 * 25 =$	37187.5
(B) Revised budgeted sales x Standard Margin =	$595 * 4.5 * 25 =$	66937.5
Material price operational variance (A – B) =		-29750
<u>Chemicals Y</u>		
(A) Original budgeted sales x Standard Margin =	$595 * 2.5 * 20 =$	29750
(B) Revised budgeted sales x Standard Margin =	$595 * 4.5 * 20 =$	53550
Material price operational variance (A – B) =		-23800

Material price planning variance:		
<u>Chemicals X</u>		
(A) Revised budgeted sales x Standard Margin =	595 * 4.5 * 25 =	66937.5
(B) Actual Sales Quantity x Standard Margin	850 * 25	21250
Material price planning variance (A – B) =		45687.5
<u>Chemicals X</u>		
(A) Revised budgeted sales x Standard Margin =	595 * 4.5 * 20 =	53550
(B) Actual Sales Quantity x Standard Margin	750 * 20	15000
Material price planning variance (A – B) =		38550

Efficacious analysis of all major merits as-well-as demerits relating to the application of variances in assessing managers' performance:

Variance Analysis simply recognised as mechanism by which the budgets of various entities can be regulated (Aureli, Del Baldo and Lombardi, 2019). The analysis of variance can be conducted on daily or weekly or even on monthly basis, where overall actual performance results are reported about budget of an entity. These performance statistics entered are utilized for comparison with figures budgeted for determining variations that arise almost inevitably. Such differences are regarded as variance; thus, the entire process is regarded as variance-analysis. Basically, the variance analysis approach is considered as one of main method to evaluate financial performance of companies. Though, there are a range of techniques to assess financial performance, but variance analysis is too effective. The rationale behind is that it

considers to compute variances for each and every segment. In addition to this, by help of variance analysis it becomes easier for managers to know about which activities are under or over performing during an accounting cycle. In order to understand practical concept of variance analysis, below an example is presented which is as follows:

Sales revenue variance:

<i>Month</i>	<i>Actual sales revenues</i>	<i>Estimated sales revenue</i>	<i>Variance</i>
January	50000	40000	10000 A
February	60000	90000	30000 F
March	70000	50000	20000 A
April	90000	100000	10000 F

This table is indicating that, above mentioned data is showing number of variances including favourable and adverse. So, it is the way through which a company can know their performance for each and every month separately. In accordance of computed value of variances, it becomes easier for managers to take suitable steps in the area in which there is need of improvements.

It is just a common example of variance. The variance analysis is not limited to a particular aspect or area. There are a number of other variance which can be used by managers to take corrective actions for decision making. Some example of variances is sales variance, labour variance, material variance and many more. In relation to mentioned company of case study, this can be stated that there are a range of variances which have been computed with an aim of taking corrective decision about make or buy.

In a scenario at which budgeted-figures surpasses that sum of actual outcomes, then variance recognized is favourable which means that the money spent was less than the amount budgeted. An unfavourable variance originates when actual-outputs are more than budgeted (Zandi, Khalid and Islam, 2019). Variances act as effective indicator which support management's decisions. For proper study of variances within an organisation, it is appropriate to conduct the task along with some basic measurements in 4 phases. First, one has to do what is alluded to as budget flexion. This is accomplished by the implementation of a new budget in order to equate it with initial budget as well as actual budget reached during the financial year. Column section of original, updated and current budget shall be drawn up and the various income shall be measured. The gross and fixed expenses are excluded from the overall revenue value in the estimation of the benefit. The value from the initial and updated estimates is first applied to variance between both the two. The next phase includes comparing the profits made by actual and initial budget in order to achieve real difference as observed in the financial year. The second significant aspect is variance analysis. If the information is derived from original, updated and real estimate, variance can be easily evaluated. For instance, If the variation is attributable to price at which separate sales are made, this is recognised as sales price variance.' In both situations, price of product involved is measured in order to ascertain differences and hence variances. Following points provide detailed discussion regarding merits and demerits linked to use of variances for assessing managers' actual performance:

Merits:

- Variances are effective evaluation tool which enable management to evaluate each major aspect to organisation as to find out the weak areas which are detrimental in performance of organisation (Gamayuni, 2019).
- The analysis of variance offers insight as to what is occurring in economic and strategic world in which business works. The early signs of economic slowdown which result in negative variations in statistical categories tracked by the organisation.
- Variances identified assist managers in making a periodic comparative analysis of individual costs with model costs in order to assess output and to undertake steps to retain cost control. Model expenses help to control expenses by implementing the variance-analysis, i.e. by identifying only certain things that do not follow the model or surpass the standard (Łada, Kozarkiewicz and Haslam, 2020). Variances tend to build cost-conscious behaviours, since they render cost differentiation easily visible by management.
- Analysing variances and identification of their effects are useful for management in deciding pricing policies, preparing proposals for potential orders, making plans the production of products and new methodologies, and providing cost forecasts in managerial decisions.
- Variances, properly determined, can expose inefficiencies of processes that can be systematically explored as well as remedial action being taken. Variance-analysis is useful for preparation of the budget since identified variances at various stages of production and within other key cost centre are incorporated in budget to make it reliable.

- Favourable variances that managers deem to be fair can foster efficiency and effectiveness. They have metrics that individuals could use to measure their performance.

Demerits:

- Variations may be used by managers and other personnel for their own benefits. management personnel can take inappropriate steps to achieve a desirable variation or to reduce an unfavourable variance (Labrador and Olmo, 2019). For illustration, the organization may buy increased quantities of poor quality materials at lower rate only so that the material utilisation difference can be beneficial. Staff may also attempt to covering up unpleasant variances in order to disguise their inadequacies or to support them individually.
- The variance reports are typically prepared month-end-basis and are often framed days or weeks just after end of month. As a result, the details in the reports could have been so outdated that it would be almost worthless. Timely, regular reports which are reasonably correct are preferable than simple-infrequent reports which are quite reliable but out dated by time they are reported.
- Variances are based on standard-costing system which aim to prioritise conformity with standards while ignoring other essential priorities such as preserving and enhancing efficiency, on-time performance and customer loyalty. This propensity could be decreased with the use of external success metrics that reflect on certain other goals.
- Taking decision considering merely favourable and unfavourable variance and ignorance of other factors may lead to inappropriate decisions as well as some time lead to rigidity in decision-making.

- In a sector where business environment changes rapidly, decisions and performance evaluation based on variances analysis is not appropriate, because variance analysis is based on just difference between standards established by management and actual performance (Johanson and Madsen, 2019).
- Standards used to derive variances are based on management's perceptions, observation and experiences, thus there are huge chances that such standards are inappropriate or not consistent with industry standards.

So these are some common advantages and disadvantages of variance analysis. Though, the demerits are not so sensible and applicable for all types of companies. It needs to be implemented in a perfect manner so that valuation of financial performance of a firm can be done.

Part B

Make-or - buy choices is a process by which a company opts for in-house production or product buying. Make-or - buy decisions often refer to a sourcing process that conforms with the advantages and expenses of producing an internal production performance or picking an alternative provider for product lines (Liem and Hien, 2020). To measure costs correctly, a business should consider those factors that are important to the purchase and distribution of the materials for the production of in-house manufacturing.

In the sense of in-house manufacturing, a company needs to consider costs associated with the procurement of the finished commodity and the costs of the processing. The related expenses which include extra work done to produce the items, storage needs, overall cost of storage, cost of materials and much more. On the other hand, the buying costs associated with a provider's sale of the commodity which include the price of the item itself, other delivery or processing fees and the relevant local taxes.

In addition, expense relating to the handling of purchased products and labour costs involved with purchasing products in storage is often included in the category of manufacturers' purchases of goods.

The case-study addressed on XLG company that focuses on decisions to make or purchase or import. Management needs to take a make-or-purchase judgement involving the FAMA Q in the corresponding case-study circumstances. It is a cleaning item for business handling high-quality FAMA Q production. This item is patent secured and XLG business plans to make it in-house. Business purchases FAMA Q from Brazil, and shipping this product to the company was costly because of country-wide lock-downs applied by government and parliament of UK. This commodity has been costly to bring into the business. It can be delivered by air, but due to lock-down, the selling price of FAMA Q has lifted by 4.5 per commodity as well as the prior price of 3.7 per item.

Despite this dynamic scenario, enterprise now plans to manufacture in-house FAMA Q. The price of an object is largely an important factor in making or buying decisions. The original regular FAMA Q price for each product is 3. It's 2.5 Pounds to pay making FAMA Q by company. The related information given here is that the shipping time would be shortened by 15 days for the in-house production alternative.

Analysis of Making Decision:

If In-housing production of FAMA Q:	Chemical X			Chemical Y		
	Budgeted (595 units)	Actual (862.75 units)	Variance	Budgeted (595 units)	Actual (862.75 units)	Variance

Selling Price	45	26775	45	38823.75	12048.75	35	20825	37	31921.75	11096.75
Cost of Chemicals	20	11900	20	17255	5355	10	5950	17	14666.75	8716.75
Increase in cost due to in-house of production of FAMA Q			0.5	431.375	431.375	-		0.5	431.375	431.375
Total Cost	20.5	12197.5	21.2	17686.375	5488.875	10	5950	17.5	15098.125	9148.125
Profit Margin	24.5	14577.5	23.8	21137.375	6559.875	25	14875	19.5	16823.625	1948.625

Working Note:

Computation of Demand(units) based on the new scenario: (Demand expected to be risen by 45 percent)		
Chemical X	595 units + 595 units *45% =	862.75
Chemical Y	595 units + 595 units * 45% =	862.75

By evaluating the decision to purchase FAMA Q, it can be reported that sales revenue will increase by around 6559.87 and 1948.62 respectively in the relation of the output of both chemical X and Y. Consequently, the actual profits will in all cases surpass the cumulative amount of revenue budgeted.

Analysis of Buying Decision:

If Imports:	Chemical X					Chemical Y				
	Budgeted (595 units)		Actual (850 units)		Variance	Budgeted (595 units)		Actual (750 units)		Variance
Selling Price	35	20825	45	38250	17425	35	20825	37	27750	6925
Cost of Chemicals	10	5950	20	17000	11050	10	5950	17	12750	6800
Incremental cost due to importing of FAMA Q	-		1.2	1020	1020	-		1.2	900	900
Aggregate Cost	10	5950	21.2	18020	12070	10	5950	18.2	13650	7700

Profit		1487		2023			1487		1410	
Margin	25	5	23.8	0	5355	25	5	18.8	0	-775

The detailed assessment of above table reveals that such decision would lead in a favourable benefit of 5355 pounds in reference to chemical X, while profits of 775 pounds in reference to chemical Y would be decreased. Thus in the case of Y, gross value of estimated revenues would decrease from GBP14875 to GBP14100.

Thus, after evaluating all the options, it can be determined that producing FAMA Q in-house would be more practical and successful. In-house FAMA Q will be possible for the company, rather than purchasing it. Since the profit rate for the in-house production is better than for all chemical X and Y purchases / imports according to FAMA Q. XLG corporation is also firmly encouraged to produce FAMA Q in-house, but businesses must consider other FAMA Q-relevant considerations such as cost benefits, FAMA Q's rights, etc. before making definitive decisions.

CONCLUSION

From aforementioned case-study report this has been effectively articulated that Managerial accounting is advantageous to the organisation in attaining its aims, goals and targets; evaluating prior results and prospective directions. This not support decisions taken by managers but also provide clear base for future actions and operations. This is wide filed which also involve identification of problems and resolving them within reasonable time-frame. Management accounting offers effective classification and interpretation of raw data as well as convert such raw-data into more meaningful and useful information.

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