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European International University

Module Assignment: Managerial Accounting Report

Swip 50 Limited

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1. Profit Statements for Swipes 50 Limited for the months of February and March

A. Profit Statements using Absorption Costing for February and March

a) Profit Statements using Absorption Costing for February

Swipes 50 Limited		
Profit Statement (Using Absorption Costing)		
February		
Sales (11,500 Units at €22 per unit)		**€ 253,000**
Less Cost of Goods Sold		
Beginning Inventory	€ 0	
Add COG Manufactured (12,500 Units)	€ 79,500	
COG Available for Sale (12,500 Units)	€ 79,500	
Less Closing Inventory (1,000 Unit *€6.36)	€ 6,360	€ 73,140
Gross Profit		**€ 179,860**
Less Selling & Administration Expenses		
Fixed Selling & Administrative Expenses	€ 36,225	
Variable Selling & Administrative Expenses	€ 8,275	€ 44,500

Net Profit for February (Using Absorption Costing)		**€ 135,360**

b) Profit Statements using Absorption Costing for March

Swipes 50 Limited		
Profit Statement (Using Absorption Costing)		
March		
Sales (15,500 Units at €22 per unit)		**€ 341,000**
Less Cost of Goods Sold		
Beginning Inventory (1000 Units @6.63 per unit)	€ 6,360	
Add COG Manufactured (14,500 Units)	€ 87,350	
COG Available for Sale (15,500 Units)	**€ 93,710**	
Less Closing Inventory (0 Unit)	€ 0	€ 93,710
Gross Profit		**€ 179,860**
Less Selling & Administration Expenses		
Fixed Selling & Administrative Expenses	€ 48,825	
Variable Selling & Administrative Expenses	€ 8,275	€ 57,100
Net Profit for March (Using Absorption Costing)		**€ 190,190**

B. Profit Statements using Variable Costing for February and March

a) Profit Statements using Variable Costing for February

Swipes 50 Limited		
Profit Statement (Using Variable Costing)		
February		
Sales (11,500 Units at €22 per unit)		**€ 253,000**
Less Cost of Goods Sold		
Beginning Inventory (0 Units)	€ 0	
Add COG Manufactured (12,500 Units)	€ 50,900	
COG Available for Sale (12,500 Units)	**€ 50,900**	
Less Closing Inventory (1000 Unit @4.072 per unit))	€ 4,072	€ 46,828
Variable Manufacturing Margin		**€ 206,172**
Less Variable Selling and Administration expenses		€ 36,225
Contribution Margin		**€ 169,947**
Less Fixed Expenses		
Fixed Selling & Administrative Expenses	€ 8,275	
Fixed Production Overheads	€ 28,600	€ 36,875
Net Profit for March (Using Absorption Costing)		**€ 133,072**

b) Profit Statements using Variable Costing for March

Swipes 50 Limited			
Profit Statement (Using Variable Costing)			
March			
Sales (15,500 Units at €22 per unit)			**€ 341,000**
	Less Cost of Goods Sold		
	Beginning Inventory (1000 Units @ 4.072 per unit)	€ 4,072	
	Add COG Manufactured (14,500 Units)	€ 58,750	
	COG Available for Sale (15,500 Units)	**€ 62,822**	
	Less Closing Inventory (0 unit))	€ 0	€ 62,822
Variable Manufacturing Margin			**€ 278,178**
Less Variable Selling and Administration expenses			€ 48,825
Contribution Margin			**€ 229,353**
	Less Fixed Expenses		
	Fixed Selling & Administrative Expenses	€ 8,275	
	Fixed Production Overheads	€ 28,600	€ 36,875
Net Profit for March (Using Absorption Costing)			**€ 192,478**

2. Reconcile profit calculated using Absorption Costing to that using Variable Costing.

Swipes 50 Limited		
Reconciliation Statement		
	February	March
Net Income using Absorption Costing	**€ 135,360**	**€ 190,190**
Less Fixed manufacturing Overheads carried forward that is Closing Inventory	€ 2,288	
Add Fixed Manufacturing Overhead carried forward that is Beginning Inventory		€ 2,288
Net Income Using Variable Costing	**€ 133,072**	**€ 192,478**

2. Explain how each method differs from the other method and also explain the importance of each of the methods:

To better understand Absorption and Variable Costing, its first important to know what is meant by Managerial Accounting. Sometimes called Management Accounting, it's also known as Cost Accounting - but regardless of the title used, it's a process of analyzing business costs and operations in order to prepare internal financial reports that are used to aid management decision making processes in achieving the business strategic and other goals. The word internal is important, as these reports are typically not seen or used by others outside the company. These economic records have proven invaluable and vital for management in order that they can form efficient decisions; but as importantly, managerial accounting is also a very effective process for forecasting and planning - especially for long-term planning. Additionally, managerial accounting is helpful for creating budgets in businesses. In summary, managerial accounting has proved pivotal in helping management make sound financial selections based on its benefits to forecasting, planning and budgeting – both in the short and longer-term.

Variable Costing and Absorption Costing are the two key foundation methods in Managerial Accounting – however both have both disadvantages and advantages. However, it's worthwhile noting early, that under Generally Accepted Accounting Principles (GAAP), only Absorption Costing is allowed for any company-external financial statement reporting. However, within the business there is a choice of using either absorption costing or variable costing in determining profits and profit-reporting.

Before we look at a comparison of both methods, we must firstly understand the meaning and importance of fixed-overhead-expenses – and this leads us to an understanding of how absorption costing and variable costing differs and compares. By most definitions fixed overhead-expenses are things that don't change regardless of production-levels. Fixed-overhead expenses examples include such items as: rent, insurance, full-time employee salaries and/or equipment leasing charges. Note: in other words, these expenses continue regardless of the volumes of sales or production output. (Noreen, et al., 2016)

The following sections outlines a comparison of both cost accounting methods, first we will look at Absorption Costing and follow this with a look at Variable Costing: Also known as Full Absorption Costing, the more simplified name of Absorption Costing is a method where a part of the fixed-overhead-expenses are applied to the cost of manufacturing products. The calculation creates a per-unit cost basis – and is done easily by dividing the fixed costs total by the number of units produced and sold during the reporting period. The end result is a per-unit-cost for each unit produced and actually sold. The method of absorption costing involves only allocating the fixed costs across all the units produced over an accounting period.

This type of costing is also known as full costing and it involves treating the costs of all manufacturing components such as direct material, direct labor, variable overhead and fixed overhead in the product costs as per the generally accepted accounting principles (GAAP). This method of costing allocates the fixed overhead costs across all the units manufactured and thus helps in determining of per-unit cost. It generally results in identifying the two categories of fixed overhead costs, that includes cost of goods sold and inventory costs. The major importance of using absorption costing method is that it enables the companies to develop a suitable pricing policy that includes fixed and variable manufacturing costs. It ensures that prices are determined based on all the cost incurred in the production process. It avoids the separation of costs into fixed and variable that cannot be done in an easy and accurate manner. In addition to this, the method of accounting also helps in determining accurate profitability as all the sales and marketing expenses are recorded under the same period. However, the major drawback associated with this method is that some of the period costs does not have any future relevance and thus should not be included within the cost of product and inventory.

On the positive side, the Absorption Costing method offers the advantage when you have finished goods in inventory during the reporting period, but which were not sold. Because each product in inventory has per-unit amount assigned for fixed-expenses, each item in inventory stock has a value assigned that also includes a part of the fixed-overhead-expense. Therefore, until sold, a product is not reported as an expense until it is actually sold and removed from inventory.

Some companies like this more because profits can be improved for a certain reporting period; however, this method has a negative in that it can artificially inflate the profit amounts in a specific reporting period as then not the full fixed-overhead-expenses are deducted if all, or none, or just some of the manufactured products have been sold. This can be misleading when an analysis of profitability is been made for the reporting period.

In difference to Absorption Costing, Variable Costing accounts for fixed-overheads in a lump sum, rather than a per-unit, expense. Additionally, under this costing method, all variable costs including production supplies such as raw materials, packaging and shipping is included.

The full cost of fixed-overheads for the reporting period is added. Specifically, these expenses are not added on a per-unit as-sold basis – instead, these expenses are subtracted from the revenue amount as a lump-sum-expense. (Noreen, et al., 2016). Variable costing involves including only the variable costs that is incurred in the production process. This type of costing method involves emphasizing only variable production costs for costing of products and valuation of inventory.

This type pf costing unlike absorption costing integrates all fixed overhead costs into a single expense and reports them into a single line item on the balance sheet.

The major benefit of using variable costing as compared to the absorption costing is that it enables only in identifying the significant costs that were incurred in developing a product or service. Also, this type of costing helps in developing income statement by the use of contribution margin that leads in attaining better information in context of cost volume profit analysis (CVP) analysis. The absorption costing does not help in undertaking a CVP analysis.

Therefore, Variable Costing will only show profits after all the expenses have been paid during the reporting period. So even if there is zero sales revenue from goods manufactured during the reporting period – the business still has to account for all the production expenses. Of course, when the produced goods are eventually sold from inventory, the business will report only income without a corresponding expense.

As a disadvantage of Variable Costing we therefore show a complete payment for all fixed-overhead-expenses for the reporting period in which they occur. Even if none of the products produced are sold, a deduction of the full cost of fixed-overhead-expense must be made – or in other words, this means that the report may show a lesser profit for the reporting period because you need to show your complete overhead-expenses even when maybe none or only some of your products. The report will show reduced income because of unsold products but full expenses are still accounted.

In conclusion, even though Variable Costing does seemingly include more expenses, it cannot be included as a GAAP method – as the rules say that all related revenue and expenses should be record within the same reporting / accounting period. Additionally, Variable Costing does not include the allocation of fixed-manufacturing-expenses – and this also makes it unusable for reporting purposes externally. Therefor Variable Costing is typically confined to its use as a decision-making tool for the improvement of business operational effectiveness. (Patankar, 2019). Having said that however the business managers still largely adopts the use of variable costing for conducting break-even analysis, determining the contribution margin and enhancing the decision-making in context of improving the operational efficiency. It can be stated on the basis of analyzing the important characteristics of both the costing method that variable costing should largely be applied by the business companies that are involved in manufacturing of diversified product lines. This is because it largely assists in determining the profits attained from each of the product line in an accurate manner. On the other hand, the firms that are involved in developing a single product line can adopt the use of absorption costing as the method help in determining accurate price level on per unit basis of products manufactured. This is because all costs are absorbed by the products that are manufactured in the method of absorption costing. However, as per the accounting standards firms are allowed only for adopting the use of absorption costing as variable costing seems to contradict the matching principle which states that all related revenue and expenses should be recognized within the same

accounting period.

3. Three ways the Swipes 50 Limited can improve its Accounting Systems

Managerial Accounting provides valuable production performance data to the business management; and so, helping them to make vital economic decisions the areas of forecasting and planning. Managerial Accounting is effectively a control technique used on any variances from the comparison of the actual results against budgeted results. Therefore, this makes Managerial Accounting a very effective resource-planning tool when it is used to focus on longer-term planning. Additionally, it can be used as an effective tool for resource-control due to its ability to focus on present results. (Warren, et al., 2019)

So, as a performance measurement method, the use of Managerial Accounting could be said to be an invaluable tool to try and ensure manufacturing success and profitability. Especially in manufacturing, it's important to, as early as possible, introduce a rigorous management accounting system that is used to ensure that all costs and expenses are properly accounted-for and controlled. (Patankar, 2019)

In the case of Swipes 50 Limited, it's true that the company has implemented at least the basics of a relatively simplistic Managerial Accounting System. However, for the details of that data to be more effective for management to use in making critical and strategic decisions, more and more detailed information is necessary in order to improve its Accounting System performance. Three important ways through which I believe that Swipes 50 Limited can improve its Managerial Accounting System is as follows.

1. Budget Reporting – comparing Actual vs Forecasted Results

The Managerial Accounting System is not a once-off activity, nor is it a short-term process. Additionally, the importance of forecasting / budgeting and planning cannot be overlooked – nor can the relevance of the control process thru Managerial Accounting be overlooked or lessened in any way.

In a way, forecasting and/or budgeting is providing the business success baseline – from which everything is then measured and evaluated. Managerial Accounting needs this baseline as part of its regulatory framework that can be used to:

• Develop plans

• Evaluate the performance of departments

• Help eliminate variances

• Minimize future uncertainty, and

• Help create more controlled future planning

Budgeting or Forecasting are integral parts of an effective Managerial Accounting System and it is essential to achieve the goals and objectives of the business. It can be used to achieve targeted profits through controlling added and possible wasteful costs incurred through the budgeted year and focusing on quality. Budgeting ensures that costs are allocated to those activities that help to achieve the strategic objectives of the business – and can play an important role in building key performance indicators (KPI's) for individual staff, managers and departments as a whole. (Noreen, et al., 2016)

The process of drafting a budget provides an opportunity for each department to provide their recommendations and contribute towards the business vision – but the budget must be wellplanned and properly indicate the duties and responsibilities for each staff member. Finally, budgeting will greatly improve the Managerial Accounting System as it is one of the most important facets of the businesses internal control system mechanisms and therefore can be used to compare the actual results with budgeted results to calculate any variances against actual performance. Effective budgeting / forecasting will provide enormously helpful feedback to management and so help eliminate or at least minimize any variance – and therefore to help improve the business profitability performance. (Warren, et al., 2019)

2. The use of more Managerial Accounting techniques

Apart from Variable and Absorption Costing, there are other Management Accounting techniques that may be implemented to help integrate the management performance with the financial performance of the business. Management Accounting techniques such as cost volume profit, standard costing, marginal costing and cash flow management will help Swipes 50 Limited to evaluate different aspects of their cost information and then be able to integrate the resultant data with the financial performance of the business. As an example, cost volume profit analysis would provide valuable information on the break-even point of a unit of manufacture – or to alert on the number of units required to be sold in order to achieve the targeted profit. (Warren, et al., 2019)

3. Introduction of activity-based costing:

As it is shown in the Swipes 50 Limited given information outline, the company manufactures only one product and all therefore all overhead-expenses / costs have to be directly applied to that one product production; however, this also means that there may be some overhead costs which are not related to the product and/or are occurring with no purpose. The implementation of an activity-based costing system, the cost from each department will be separated and only those overhead-costs related to that product will be added. This will help to separate value-added costs and non-value-added costs from the total-overhead costs. This technique will help eliminate or minimize non-value-added activities and therefore help to improve the overall profitability of the company. In addition, this activity-based costing will provide information that can used to calculate the exact profitability of each new product manufactured by a company such as Swipes 50 Limited.

Activity-based costing is much more reliable and accurate cost allocation method as compared to Absorption Costing; as Absorption Costing takes the full amount of manufacturing overhead and spreads this overhead across all production quantities of all products taken together. It is clear then that some products have utilized only some of the overhead-costs as compared to another. This issue can therefore be resolved quickly, accurately and easily through use the of an activity-based costing system. In conclusion, it is true that activity-based costing may be superior when compared to Absorption Costing method as it assigns overhead-costs to the correct product. (Patankar, 2019) (Warren, et al., 2019)

5. Why the managerial accountant's job is important within a manufacturing Company?

The role of a management accountant is not only important, it is very important, as it covers the entirety of an organization. (Kulkarni, et al., 2018). The job of the management accountant includes the collection, recording and reporting of financial data from, perhaps, several business units throughout the organization. The job also involves the observation and analysis of budgets / forecasts; and then to understand and recommend their funding. This last section includes an estimation of the cost of raw materials, labour, production, sales, marketing, sales, advertising and the businesses internal operational costs.

Additionally, the management accountant needs to co-ordinate with all relevant business units in order to make an overall analysis of the company's functioning capital and availability of funds and then to report all this information to senior management and the Board of directors. Thus, the management accountant is the key source of information required by Directors and CEOs that they then use to make decisions.

Input to the decision-making process by the management accountant is the function of tracking internal costs on any business process that helps a company make decisions related to the production, operation and investments. Companies need management accounting and the management accountant to be able to understand the efficiency of their budget, the cost of their operations and then allocate funds accordingly in production, sales and investment. (Noreen, et al., 2016)

The role of a management accountant is thus, very crucial for a company's success. Their role and responsibilities are so huge that even a single miscalculation or underestimation of any business plan by a management accountant can put a company's future in danger. The management accountant enforces both internal costing procedures and generally accepted accounting practices to ensure ongoing compliance.

Timing is an important factor for making all plans for a company's management. A management accountant's functions are time-related as they need to make predictions, budgets and report within a stipulated period so that they can be implemented quickly without delay at a time of need. Timely forecasting is particularly needed in order to take into consideration market uncertainties. The budget needs to be according to the available working capital and exposure to market risks thus a certain amount of accuracy is very necessary. Before reporting, a management accountant has to ensure accuracy of all information gathered to help in correct decision-making.

Conclusion

Finally, a management accountant needs to be aware of everything, be it political situation that could affect market, inflation, other exposures in the market, competition, cost of labour, raw material, internal operations, coordination among different departments within a company as well as its interaction with rest of the business world in order that they can inform company management in advance so that they can take financial decisions with consideration of available funds and requirements. (Kulkarni, et al., 2018) Due to the particular complexity of a manufacturing company the role of the management accountant is therefore even more important, or at least as important as most types of businesses

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