COVER PAGE AND DECLARATION

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1. Introduction

Managerial accounting originated in the 19th century, it was birthed thanks to the increase in numbers of factories due to the industrial revolution (Gutiérrez et al., 2005). The large factories that came to being created a need for a new type of accounting. Large factories introduced a new way of manufacturing, where every step of making a product was performed under the same roof, and the need to simplify the management of these steps, and increasing their efficiency was created.

Managerial accounting is a practice that is involved with the gathering, analysis and interpretation. Then it is passed on to the managers so that they are able to take decisions that are informed and insightful. Managerial accountants help with planning; they do that by creating budgets (Johnson, 2021). In this paper the different ways a managerial accountant serves their firm will be expanded upon, as well as the two different methods of costing, absorption costing and variable costing, their benefits and drawbacks. In this assignment the two methods of costing will be applied to the data provided for the company swipes50 ltd and it will expand on how the company can improve its accounting systems. Last but not least this paper will discuss the different responsibilities and roles taken on by a managerial accounting and how important those roles are.

2. Variable costing

In managerial accounting a variable cost is the cost of producing one unit, and variable costing is a concept for accounting costs. In simple terms, it is one way to calculate product cost. Variable costing is meant for internal users for purposes such as short term decision making, comparing product lines, making a break even analysis, and optimizing operations, specifically production. It is also used to set product prices, and comparing different production systems. When using variable costing, the fixed manufacturing overhead is allocated as a period cost and is not attached to the product unit. This method categorizes costs as variable or fixed. Direct labor and direct materials are considered to be variable costs. Rent, insurance policies, and loan payments are considered as indirect, fixed costs. (Hasan, 2015)

2.1. Advantages of Variable Costing

Variable costing helps companies with predicting near future levels of sales and production. This helps them figure out the direct expenses. This method provides a good source of data that informs management on how to price their product. This is done by finding the production volume which when the cost of production is increased by that of producing an extra unit is the same as the increase observed in revenue. In variable costing the fixed, variable, and administrative expenses are divided into their own categories which make it simpler for management to understand the cost of producing and selling a product and therefore control it, and further refine the process.

2.2. Disadvantages of Variable Costing

Variable costing does not charge fixed manufacturing overheads to production costs. Hence, it will not provide useful information when it comes to long term pricing. Inventory and unfinished work will be undervalued with this method, again because it decides not to allocate fixed manufacturing overhead to product costs. Variable costing is not an acceptable method for issuing official reports for external users. This is because it does not follow the rules of the Generally Accepted Accounting Principles.

2.3. Importance of Variable Costing

The most important role of variable costing is to find ways to optimize production and operations. This is done in order to be able to produce units with a lower cost than their selling price, in order to be able to make a profit, or increase profits.

3. Absorption costing

Absorption costing or the full cost method of accounting is one way to determine the cost of production. It is called absorption costing because production costs of a unit absorbs expenses that would usually not be a part of the equation, when using different accounting methods, as is the case in variable costing. In this method, all costs are considered to be, and are treated as product costs, with no regard to whether they are fixed or variable. Which means, each unit produced has a cost which is consists of direct labor, direct materials, fixed and variable manufacturing overheads, and direct expenses. (Fekrat, 1972)

When a company is filing its taxes and or is issuing official reports it will have to use absorption costing to make its financial statements. This is due to the fact that absorption costing is a very accurate way of accounting for costs and that it complies with the rules of the Generally Accepted Accounting Principles. The absorption costing method is useful when presenting statements to external users such as the Internal Revenue Service.

Absorption costing is used to calculate profits, and to determine the inventory valuations for the purposes of making a financial statement. however, it is limited when it comes short-term decision making. It works by allocating manufacturing overheads to output by an absorption rate based on labor hours and machine hours. It focuses charging business costs to unit production costs, calculating profit, and calculating the values of the inventory. It is most appropriate for manufacturing companies that base the allocation of manufacturing overheads on machine and labor hours.

3.1. Advantages of Absorption Costing

Absorption costing is very accurate, because it includes all expenses and relates them to production in the process, such as rent, and insurance etc. The biggest advantage absorption costing has over variable costing is that it is compliant with the GAAP rules, which makes it suitable for making official documents that are meant to be released to users outside the company. This method is also a very useful tool for keeping an accurate record of profits, which provides a clear understanding of lucrativeness. This is particularly important for making decisions regarding volume of production when preparing for seasons where sales might spike or sink.

3.2. Disadvantages of Absorption Costing

The absorption costing method has a few disadvantages. Firstly, it is not suited for comparing the profitability of different product line. It also creates a distorted image of the profits. When the amount of units sold is lower than the amount of units produced, that period may seem to have yielded higher profits than it actually did, and that is due to some fixed costs not getting subtracted from the profits. This might create an incentive for managers to increase production to ensure a higher number in inventory just to project an illusion of higher profitability. This defeats the purpose of absorption costing which is to be able to see trends in the market and build predictions upon them, not to create a false image of profitability. When fixed costs are a significant part of the production expenses, then this method will give a poor analysis of the situation. This is because

3.3. Importance of Absorption Costing

Absorption costing is important because, gives an accurate analysis the amount of profit made during a period of time. It is used for submitting official reports, and tax filing. Furthermore, it is very useful when used to make long-term investment decisions. Absorption costing is very useful when it comes to studying trends over a long period of time. It exposes certain trends and themes that happen during the year. The longer the period over which the information is studied, the clearer these trends become and managers can then make decisions on whether to invest in certain activities, such as stocking up in inventory to prepare for a surge in purchasing numbers.

4. The Difference between Variable and Absorption Costing

The two methods are concerned with creating images that are fairly distinct from each other, due to the fact they follow slightly different ways of accounting, also they cater to different audiences. The variable costing method the users are internal, such as management. Under the absorption method of costing, the intended users are external, such as auditors. The variable costing method puts its focus costs that fixed or variable, while absorption costing focuses on direct and indirect costs. The variable method meant to help managers make insightful short term decisions while the absorption method helps with making more comprehensive predictions and long term investment decisions. Absorption method is used to calculate profits over a given period of time while variable method is used to calculate when products will break-even. (Gersil & Kayal, 2016)

5. Three ways to improve accounting systems

Every company needs to keep on improving their accounting systems in order to have access to more accurate, and therefore, more useful information, to base their decisions upon. There are a few ways to refine accounting systems and their processes. The three ways discussed below will shed light on how to improve the quality of data collected its accuracy, and reliability.

5.1. Software

Technology is a powerful tool and not making use of it, is an unwise choice. Enterprise Resource Planning systems are a type of software that caters to the needs of an accounting department by automating a number of tasks. An ERP system will help the company get access to accurate information that is up to date, which in turn will positively impact the decision making process of the company. When decision making process are refined and improved, customer satisfaction, competence, and revenues are sure to improve as well. ERP systems replace old databases that were divided and separate, like accounting, materials management, payroll, and human resources etc., with a database that allows access to the information that management needs when they need it, and that is of utmost importance when it comes to improving revenue.

5.2. Data collection and Organization

Swipes 50 ltd can improve its accounting systems by improving the way they group the information they've gathered. The table provided does not separate the data into relevant groups such as period costs, and manufacturing costs, which might compromise the efficiency of the process, by giving accountants information that is not organized. This can be overcome by setting guidelines and protocols that help guide the process of data collection and presentation.

The direct costs are not presented on a per unit basis, which creates more work for those would like create financial statements out of this information. Giving this kind of information in the same way you would a period cost might cause some confusion. Improving this will lead to a more refined system that provides a more streamlined process.

5.3. Training staff

Investing in training staff members can be expensive, but it pays off very well. This investment will be immediately reflected in the efficiency of completing tasks, and the quality of the results acquired. This is due to staff members gaining more experience, a more comprehensive insight of the process, and a better understanding of the market, and the business. This will be a turning point where reports are more detailed, data is collected in a more organized manner, and increased software literacy which decreases amount spent on a task.

6. Why is managerial accounting important?

Managerial accounting encompasses many parts of the financial results of any given company. They include but are not limited to operating expenses and cost controls. The company needs to have a proper forecast to which decisions are made to preserve, and improve the company's health and profitability. Managerial accounting gives the decision makers in the company the insight they need to do their job. It deals with revenue, operation costs, sales and controls over expenses. And finally it is crucial for the company to make predictions which are dealt with comprehensive plans and appropriate budgets. All of this comes together to make sure that the company is able to compete in an edgy and fast growing economy, and that is done through enhancement of internal financial affairs.

Management decisions are guided by the processes of planning, directing, and controlling. Planning is the key to laying out a clear path to the success of any business. It is the process of making targets and the course of action to ensure that a company reaches them. Planning for a company is not the same planning for an individual. That is because a company has largely different resources to be managed in specialized ways, not to mention the fact that planning for a company includes planning for a large number of individuals. Planning for a business can be split into three different parts. Strategizing, Positioning, and Budgeting. All three will be discussed below in order to show the need for the presence of managerial accounting in a business. Strategy is an extremely important assignment to management. In fact, companies invest large amounts of money and time in developing suitable strategies. When employees are busy with their daily tasks, it is common for them to forget just how important strategic goals are to reach. Moreover, the strategy of company is a defining feature of the business. The strategy of a company is concerned with following and preserving the core values, the objectives, and mission of the company. Managerial accounting department comes in to ensure that such a strategy is fulfilled to the best of its ability, and it does that by ensuring that the objectives of the company are being met in a sustainable way. A company that pledges to be a friend of the environment for example will need accountants to make sure that waste disposal is done properly and in a cost effective way, so as to not harm the company's finances. Positioning depends on collecting and assessing accounting data. It is a crucial part of the planning process. The cost, volume, profit analysis is a constituent of the positioning process and is useful for basic instructions and short term decision making. It is concerned with reaching and calculating break-even points and reaching income targets, and the nature of cost behavior. It is crucial for scaling business models to achieve profitability. Branding/sensitivity/competition/pricing, Branding is not to be taken lightly when it comes to positioning. Branding requires a hefty investment without certain payback. Products might require being positioned as flagship, to be branded as a topnotch item, which requires a big investment, and on the opposite end a product could depend on having a competitive price to ensure the sales are driven properly. The information needed to make the choice between the two is quite the task for internal accounting department. The internal accounting staff will need to get information that is based on likely scenarios. That is not all. The pricing of a product needs to be an informed decision keeping in mind the competition in the market.

Global trade and transfer is the part where management accountants have to survey and analyze business activities on a global scale. They perform extensive research about logistics, taxes, and laws governing the different countries and territories that are of interest to the company. When dealing with global trading all transactions must be meticulously measured in order to form proper transfer prices.

Budgets are regulatory plans governing the finances available for a project or endeavor. The following are three types of budgeting that a managerial accountant can use. Operating budgets are concerned with structuring detailed allowances for operations and inventory. They will outline purchases made for inventory and how to plan staffing for a given project. Sometimes they even outline allowances for several departments. Capital budgets are expenditures needed for new facilities and new equipment. Capital budgets are long term budgets and they need to be evaluated in order to see if they are justified or not, and how long before they turn a profit and when pay back will be feasible. Financial budgets are concerned with cash shortcomings. Managerial accountants must be able to somewhat predict where and when they might need financial assistance from lenders and be able to convince them to assist the company.

Controlling is the aspect of managerial accounting that ensures that plans are followed to the letter, if not; they at least ensure that plans are not deviated from too much. These deviations will then be accounted for and the accountants will adjust accordingly. Controlling is a high level task, it is complex and in large companies it might be the responsibility of over a hundred staff members that are headed by a person that holds the position known as "controller". In basic terms the task of a controller is to make sure plans are followed and bad situations are either avoided or corrected. In order to control situations properly, the company needs to monitor the conditions. That will help it take corrective measures successfully.

Standard costs are a tool that helps managerial accountants monitor the efficacy of production and it also helps them control costs. These standards are made to simplify the process of identifying deviations. By presenting a benchmark upon which productive activities are compared. Variances are the significant deviances from the standard costs set by the managerial accountants. These serve as red flags that warn managers that corrective measures are needed to rectify errors. Accountants will help managers identify these red flags and advise them on what needs to be addressed. Accountants must monitor these variances very carefully. When a company faces a surge in demand for a certain product, this might push managers to ask for higher labor hours. Accountants have to make an analysis on the variances that are observed, in order to find out if the increase in labor hours might hurt the company's finances, and then advise the managers accordingly.

Scorecards are a hands on method to monitor employee activities. The scoring system is tailored for every position. And they help managers monitor the activities that affect the company's performance, and how efficiently staff members perform them. Keeping an eye on financial results alone will not give a full picture of the performance of the company. Lower tier employee activity might be hard to monitoring through cost standards and financial statements, and so scorecards fill in this gap. However, managers should not rely too heavily on one way and neglect the other; a balance between both approaches yields the best results and provides a clearer picture for the managers.

Total quality management is an approach used to improve the performance of front line employees and customer service staff, by comparing their performance to successful rival companies as well as other businesses. Total quality management follows a scientific methodology to study how the employees work for the manager to be able to make steps for the improvement of the quality of service.

Directing is one of the managerial accountant's most important roles. Budgets, resources, deadlines, authorizations, must all be prepared and ready for the executions of plans, and they are prepared by the managerial accountant. The efforts that go into plans must be coordinated, and information systems have to be implemented, inventory status has to be known at all times and updated regularly, all of this to ensure a streamlined process of turning plans into actions. Costing is comprised of different tasks, and they are collecting, assigning, and understanding costs. There are three ways costing can happen. They are activity based costing, job order costing, and process costing. Furthermore, the two concepts of costing and they are direct costing and absorption costing which have been expanded upon in the above pages. One of the most crucial aspects of direction is the management of the production process. Inventory, manufacturing, assembly lines all fall into the activities to be overseen. One of its benefits is optimizing the production process by maximizing the efficacy and minimizing costs where possible without negatively impacting quality. The management of inventory focuses on streamlining the ordering of materials and storing of finished products, and ensuring that when needed inventory have things to offer. Another aspect of managing production is the monitoring, direction, and improvement of customer service department and quality control.

Analysis offers insight for certain decision such as custom orders, custom prices, and it answers important questions like whether to outsource certain functions like production. These analyses follow various methods, and depend on logical sequences, as to provide specific information that is important for decision making process of a managerial accountant.

In Summary, project management decisions are guided with reports, analyses, careful thoughts and persistence. The job of a managerial accountant is an exceedingly important one and the roles and responsibilities mentioned in this section show exactly how and why managerial accounting is a crucial and irreplaceable task for any company.

7. Conclusion

In this assignment it has been shown how absorption and variable costing can be applied to give two different pictures in order to give managers different perspective to aid their decision making process, and it has been shown how the two methods of costing can be reconciled and that the difference between is merely a difference of function not that they yield false or conflicting numbers. This paper also shows the advantages, disadvantages and importance of both methods, and how to improve the accounting systems of the swipes50 ltd company. The importance of the managerial accounting in a manufacturing company has been extensively discussed by going through the roles and responsibilities of managerial accountants, and how they aide and guide companies to ensure their health and success. In conclusion managerial accounting is an irreplaceable process that cannot be taken lightly or overlooked.

8. Swipes 50 ltd income statement

A	B	C
	February	**March**
Unit Data		
Beginning Inventory	0	1,000
Production	12,500	14,500
Sales	11,500	15,500
Ending Inventory	1000	0
Variable Costs:		
Direct Materials	€ 2.32	€ 2.293
Direct Labors	€ 1.52	€ 1.517
Variable Production Overhead	€ 0.584	€ 0.586
Total Variable Production Cost	**€ 4.424**	**€ 4.424**
Variable Selling and Administrative Expenses	**€ 3.15**	**€ 3.15**
Fixed Costs:		
Fixed production overheads	**€ 2.288**	**€ 1.838**
Fixed selling and administrative expenses	**€ 0.719**	**€ 0.534**

Table 1. Swipes 50 ltd income statement.

- **Absorption Income statement (February):**

Production Overhead = Total Variable Production Overhead (per unit) + Fixed Production Overhead (per unit) = € 4.424 + € 2.288 = € 6.712 / unit

Sales = 11,500 units * € 22 (-) Adjusted Cogs: Beginning Inv. 0 + Production (12,500 unit * € 6.712)	 0 € 83,900	**€ 253,000**

- Ending Inv. (1000 unit * € 6.712)	€ 6712	
Cogs		**€ 77,188**
Gross Margin		**€ 175,812**
(-) Total selling and administrative cost:	€ 44,500	
Operating income		**€ 131,312**

Table 2. Absorption Income statement (February).

- **Absorption income statement (March)**

Budget Capacity = € 28,600 / 20,000 unit = € 1.43 / unit

Used Capacity = 12,500 unit * € 1.43 / unit = € 17,875

Production Volume Variance = € 28,600 - € 17,875 = € 10,725

Production Overhead = Total Variable Production Overhead (per unit) + Fixed Production Overhead (per unit) = € 4.424 + € 1.838 = € 6.262 / unit

Sales = 15,500 units * € 22 (-) Adjusted Cogs: Beginning Inv. (1000 unit * € 6.262) + Production (14,500 unit * € 6.262) - Ending Inv.	 € 6,262 € 90,799 € 0	**€ 341,000**
Cogs [unadjusted] + Production volume variance		€ 97,061 € 10,725
Adjusted Cogs		**€ 107,786**
Gross Margin		**€ 233,214**
(-) Total selling and administrative cost:	€ 57,100	
Operating income		**€ 176,114**

Table 3. Absorption Income statement (March).

- **Variable Costing (February & March)**

	February		**March**	
Sales	**11,500 units * € 22**	**€ 253,000**	**15,500 units * € 22**	**€ 341,000**
(-) Cogs Beg. Inv. + Production (-) End. Inv.	 0 € 55,300 (1000 * 4.424) = € 4,424		 € 4,424 € 64,148 0	
Cogs		**€ 50,876**		**€ 70,460**
(-) Variable selling and administrative cost	(11,500 * 3.15) = € 36,225		(15,500 * 3.15) = € 48,825	
Contribution Margin		**€ 165,899**		**€ 221,715**
(-) Fixed Production Overhead		€ 28,600		€ 28,600
(-) Fixed Selling and administrative expenses		€ 8,275		€ 8,275
Operating Income		**€ 129,024**		**€ 184,840**

Table 4. Variable Costing (February & March).

- **Reconciliation (February):**

Difference in income are resulted from fixed element of Production cost assigned to inventory under each.

Operating income under absorption. – Operating income under variable = Fixed production cost of end inventory under absorption – Fixed pro. Cost of end inv. Under variable

Left-hand equation:

€ 131,312 - € 129,024 = € 2,288

Right-hand equation:

$$€\,\mathbf{2.288} * \mathbf{1,000}\ \boldsymbol{units} - \mathbf{0} = €\,\mathbf{2,288}$$

- **Reconciliation (March):**

Left-hand equation:

€ 176,114 - € 184,840 = (-) € 8726

Right-hand equation:

0 – (€ 1.972 * 4,424 units) = (-) € 8724

- **February operating income is € 131,312**
- **March operating income is € 184,840**

9. References

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