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E-SIGNATURE: ______________________________

DATE: ______________________________

EIU Paris City Campus
Address: 59 Rue Lamarck, 75018 Paris, France | **Tel:** +33 144 857 317 | **Mobile/WhatsApp:** +33607591197 | **Email:** paris@eiu.ac

EIU Corporate Strategy & Operations Headquarter
Address: 12th Fl. Amarin Tower, 496-502 Ploenchit Rd., Bangkok 10330, Thailand | **Tel:** +66(2)256923 & +66(2)2569908 | **Mobile/WhatsApp:** +33607591197 | **Email:** info@eiu.ac

Managerial Accounting
MGT510

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1. Introduction:

A Swipe 50 limited is a 3-year-old manufacturing company located in Taiwan, specialized in laptops accessories and screen protectors. It has a unique product and most popular in the market, screen for laptop scratch protection. In general, the company sees itself as a good performing company in the business with monthly production capacity exceeding 50%. And reasonable market share among its competitors especially in the laptop's accessories market segment.

The top management need to refine budgets with expenses and to insure by numbers how well the company achieving with focus on income and product costing. The company had last two months of operation as a case study to decide about performance and as an indicator to represent company overall income and cost arising. And for deeper analysis, the company CFO planned to perform income statement with both know methodology (absorption and variable) to see how the numbers will concili with each other.

2. February & March review:

The company monthly operational, production and sales activities where almost similar and so representative for the company yearly performance. The last two months incomes and expenses reviewed and summarized and categorized into direct/indirect and variable/fixed. Bellow tables showing the financial summary:

	February	March
Production (units)	12,500	14,500
Sales (units)	11,500	15,500
Direct material	€29,000	€33,250
Direct labour	€19,000	€22,000
Variable production overhead	€7,300	€8,500

Total selling and administrative expenses	€44,500	€57,100
Swipe max production capacity	20,000	
Fixed production overhead	€28,600	
Swipe sell price	€22	

Noticing the company was operating between 55% - 80% of max planned production capacity, which leaving a space for special sales orders. The fixed production overhead calculated considering the Swipe50 factory planning to produce 20,000 unit monthly, with the company production bellow max capacity so there will be a monthly production variance.

3. Income statement:

The profit statement for Swipe 50 limited company represents all the income and expenses for the required period. Usually, the company performing such statement analysis on specified statement, Usually, quarterly, or fiscal year basis (Jason Fernado, 2022). But since the company decided to perform refining for its production process and review the product costing, its required to perform the profit (income) statement for the last two months of operation.

With this statement, the company will accurately show and present the revenues and expenditure on numerical and meaningful manner and showing in clear expenses structure in the company and give the managers the hand-on to decide and be able of planning for future product cost with clear vision of where company can cut cost for any non-added value expenses (wither fixed or variable).

3.1. Absorption approach:

With absorption approach for product costing, all costs associated with product realization and manufacturing processes is included and categorized into direct / indirect and administrative and selling expenses.

Noting the number of produced units are less than the planned production capacity, which means there will be a fixed cost production variance and considered as an extra production expense.

- February profit statement:

Production	Units	12,500
Sales	€	253,000 = (11,500 x 22)
Direct material / unit	€	2.32 = (29,000 / 12,500)
Total Direct material of units sold	€	26,680 = (2.32 x 11,500)
Direct labour / unit	€	1.52 = (19,000 / 12,500)
Total Direct labour of units sold	€	17,480 = (1.52 x 11,500)
Fixed production overhead / unit	€	1.43 = (28,600 / 20,000)
Total fixed production overhead of units sold	€	16,445 = (1.43 x 11,500)
Variable production overhead / unit	€	0.584 = (7,300 / 12,500)
Total variable production overhead of sold units	€	6,716 = (0.584 x 11,500)
Indirect expenses of sold unit	€	23,161 = (6,716 + 16,445)
Variance of unit produced		7,500 = (20,000 – 12,500)
Variant cost	€	10,725 = (1.43 x 7,500)
COGS	€	Beginning inventory = 0 End inventory = 1000 x 5.854 = 5,854 Production = 12,500 x (2.32 + 1.52 + 1.43 + 0.584) 73,175 COGS = 67,321
Adjusted COGS	€	COGS + variant = 78,046
Gross profit	€	Sales – adjusted COGS 253,000 – 78,046 = 174,954
Total selling and administrative expenses	€	44,500
Operating profits	€	130,454 = (174,954 – 44,500)

- March profit statement:

Production	Units	14,500
Sales	€	341,000 = (15,500 x 22)
Direct material / unit	€	2.293 = (33,250 / 14,500)
Total Direct material of units produced	€	33,250
Direct labour / unit	€	1.517 = (22,000 / 14,500)
Total Direct labour of units produced	€	22,000
Fixed production overhead / unit	€	1.43 = (28,600 / 20,000)
Total fixed production overhead of units produced	€	20,735 = (1.43 x 14,500)
Variable production overhead / unit	€	0.586 = (8,500 / 14,500)
Total variable production overhead of sold units	€	8,500
Indirect expenses of units produced	€	29,235 = (8,500 + 20,735)
Variance of units produced		5,500 = (20,000 – 14,500)
Variant cost	€	7,865 = (1.43 x 5,500)
COGS		Beginning inventory = 1000 x 5.854 = 5,854 End inventory = 0 Production = 33,250 + 22,000 + 29,235 = 84,485 COGS = 90,339
Adjusted COGS	€	COGS + variant = 98,204
Gross profit	€	Sales – adjusted COGS 242,796 = (341,000 - 98,204)
Total selling and administrative expenses	€	57,100
Operating profits	€	185,696 = (242,796 – 57,100)

3.2. Contribution (variable) approach:

With variable approach, only variable (wither direct or indirect) only included in the cost of goods sold COGS, the fixed direct cost is allocated to operating expenses. With the variable approach, the product costing will be more meaningful for decision making and properly understanding the operation of the company since the only the real expenses linked with the production of the units are counted without considering any other expenses supposed to be operational.

- February profit statement:

Sales	€	253,000 = (11,500 x 22)
Variable manufacturing	€	55,300 = (29,900 + 19,000 + 7,300)
Variable manufacturing/unit	€	4.424 = (55,300 / 12,500)
Variable selling and administrative / unit	€	3.15 = (57,100 – 44,500 / 15,500 – 11,500)
Total Variable selling and administrative	€	36,225 = (11500 x 3.15)
COGS	€	Beginning inventory = 0
		End inventory = 1000 x 4.424 = 4,424
		Production = 12,500 x 4.424 = 55,300
		COGS = 50,876
Contribution margin	€	165,899 = (253,000 – 50,876 – 36,225)
Fixed production overheads	€	28,600
Fixed total selling and administrative	€	8,275 = (44,500 – 36,225)
Operating profits	€	129,024 = (165,899 – 28,600 – 8,275)

- March profit statement:

Sales	€	341,000 = (15,500 x 22)
Variable manufacturing	€	63,750 = (33,250 + 22,000 + 8,500)
Variable manufacturing/unit	€	4.39655 = (63,750 / 14,500)
Variable selling and administrative / unit	€	3.15 = (57,100 – 44,500 / 15,500 – 11,500)
Total Variable selling and administrative	€	48,825 = (15,500 x 3.15)
COGS	€	Beginning inventory = 4,424
		End inventory = 0
		Production = 14,500 x 4.39655 = 63,750
		COGS = 68,174
Contribution margin	€	224,001 = (341,000 – 68,174 – 48,825)
Fixed production overheads	€	28,600
Fixed total selling and administrative expenses	€	8,275 = (57,100 – 48,825)
Operating profits	€	187,126 = (224,001 – 28,600 – 8,275)

4. Absorption and variable Reconciliation:

Reconciliation is the process of achieving balance between two different number and finding the breakdown for the reason of differences. In management accounting, numbers supposed to be so matching and representative and eventually leading to 100% true scenario. Calculating profits in either known methodology must lead to same final answer No way at one hand to be gaining profits and on other hand the other income statement with the

different methodology showing losing. So, a prof must be calculated to show both different number are actually the same, but from different perspective.

Using absorption or variable income statement in simplest form with simple production factory who sell all what produced without having a continuously varying inventory will mostly show an identical equivalent. On the other hand, in many practical situations their will be some difference between the operating profits using the two different income statement calculation methodology (variable or absorption). This gap between the two operating income coming from the inventory consideration.

When producing more than what you are selling, that can be sought as a lose in the operating come since more fixed overheads resources been used for a product which eventually not sold.

Contrary, when selling products more than what already manufactured will surly do mean we are selling some of our old inventory. Which means which will have some fixed cost of production will not show in the variable income statement since it relays only on what have been produced for the same period of time.

So, reconciliation follow bellow equation:

(Operating income under absorption – operating income under variable) = (fixed cost of end inventory under absorption – fixed inventory of beginning inventory under absorption)

	Variable	Absorption	Difference
February	130,454	129,024	1,430
March	187,126	185,696	1,430

	February	March
beginning inventory	0,00	1,000
February ending inventory	1,000	0,00
Fixed cost manufacturing/unit	1.43	1,43
Difference between operating income at absorption and variable	1,430	1,430
Difference between fixed cost at beginning and ending inventory	1,430	1,430
Conclusion	Equal reconciliation	Equal reconciliation

5. Absorption Vs variable:

Both absorption and variable costing method used to value the company work progress and inventory. With slight differences in between both methodology that gives different wholistic view for the decision maker and stakeholder financial status reporting.

5.1. Absorption:

Simply count all expenses (direct, in-direct, fixed, variable) on the product manufacturing cost, regardless wither if product being sold or for inventory, based on the principle of any expenses were originally occurred for product realization.

While companies can use any method, the absorption method is the only accepted according to GAAP financial reporting standards and governmental Tax reporting.

With absorption costing income statement, all cost of production is product cost, without any categorization wither variable or fixed type cost. The cost of unit of product are the sum of direct material, direct labour and both variable and fixed overheads.

Both variable and fixed selling and administrative expenses are treated as period cost and deducted from the gross-margin revenue as a lump sum number.

5.2. Variable:

Under variable costing income statement only the cost of production which vary and change with the number of units produced are the product cost

The cost of a unit consists of direct material, direct labour and variable overhead, which mean No fixed manufacturing expenses valued in the product cost (or alternatively the COGS).

5.3. Comparison

Absorption	Variable
Absorption costing includes all the direct and indirect costs attached with manufactured product	Contribution costing excludes all fixed manufacturing expenses from the product cost
Absorption costing requires assigning fixed overhead costs to all units produced for an accounting period (regardless of if they are sold or not)	Variable costing includes all the variable costs in COGS but excludes fixed overhead costs
Absorption costing don't show the real direct cost of the product and can mislead decision maker by increasing the number of units produced and then	Variable costing can provide a clearer picture of per-unit cost and inventory value because it excludes the fixed overhead cost

lowering the product cost then assuming the product can be sold at lower price.	
Absorption Costing is required by GAAP for external reporting purposes and governmental Tax reporting	Variable Costing is often used for internal decision-making

5.4. Importance of each method:

While both methods are approved in accounting systems and widely used and understood among company internal and external users. But still some uniqueness in each method makes it more favourable for different situations.

One costing methodology provide answers for managers which not directly easy seen in the other methodology. so, for many professional accounting and financial managers prefer to include both income statement methods in their report.

- Importance of variable (contribution) costing income statement:
  - Income is not affected by number of units produced
  - More understandable to manager since it counts the variable cost
  - Fixed cost is more visible, since it's not included in the gross profit and kept separate from the gross income, so the impact of fixed overhead cost will be direct emphasized and will help decision makers for taking proper action toward such expenses.
  - Control budgeting and planning since variable income statement all based on variable expenses so any control and budgeting mechanism will focus on the variable cost.
  - Help managers in taking decisions in pricing of special sales orders and incremental pricing cases.

- Importance of absorption costing income statement:
    - Provide a full real cost of product by including variable, fixed overheads
    - International reporting only recognizes this method according to GAAP standards
    - Tax reporting follow and recognizes absorption method only.
    - Help manager in identifying the proper initial selling price of a product.

6. Accounting system improvement:

With today technological boom and advancement and availability of many different solutions and options with on-hand and feasible costs. For many companies they adopted an automated systems and software-built operations. Which makes it easier and more accurate for data gathering, collection and processing with almost zero human errors and on-time.

Traditionally there were and accounting seasons in the company, like inventory seasons at every end of year, during such accounting seasons almost all company operations was on-hold for few day's and sometime exceeds a week, in now current new systems the inventory is as simple as a click on a software.

Modern accounting system need to invest and adopt new tools to minimize time, errors, add flexibility and accessibility.

Swipes50 company can improve their accounting systems by:

1- Adopting QR codes for inventory

   With QR system, inventory become more simplified and more traceable. No more for traditional piece by piece counting and tagging. inventory became few second process

2- Adopting software's

   A software operated system for data gathering and managing simplifies the tasks on accountant. The software to be linked with different data logging and collecting

devices so the software process the data independently in the same manner described by the accounting manager, such a daily attendance logging device which collect and send data to accounting software showing whose attending or absent or delayed at each specific day then enabling the software from accurately and automatically to calculate the salaries and deduction for each employee. Also, with software, accounting reports and charts became easier and on-request generated with different varieties focusing on subject of discussion.

3- I cloud storage

By introducing the i-Cloud storage, The Swipe50 company will enable remote access for accurate and on-time updated information for its employees. Which enable the rapid decision taking by managers who usually traveling around the world for making deals, but still need access to the financial and accounting system.

7. Managing accounting in manufacturing company:

In the modern manufacturing industries and companies, there is the challenges of the need for precise and accurate decisions making ability and a quick and no-time. Decisions can have impact on the success of the company and its position in the market segment which its operating and help the company to enhance its revenue and market competitiveness. So, manufacturing companies and managers need to have insight into all aspect of business operation to determine further action and be relaying on objective number and facts representing the real situation and trends in operations.

Managing accounting provides performance and financial reports enabling the decisions maker and manager to be ready for the coming future and formulate the company strategic plans with reference to the available information's.

Manufacturing companies need managing accounting for:

- Proper cost analysis: (ICSI house, 2017)

As simply can be defined, cost is “the amount of expenditure incurred on, or attributable to a specified thing or activity” (CIMA global. 2015). A manufacturing company is interested in ascertaining the cost of goods per unit of product manufactured. With many companies the process as straight forward as can be by dividing the total expenses by the number of units produced, but in most of the cases this can’t be simple with currently complicated and customized product. many companies now operating different production line for different products at the same time with each product utilizing not the same amount of material, labour, overhead, engineering. So, costing not anymore simply dividing the expenses by the number of produced units. With managing accounting a scientific and approved approaches presented and applied.

- Effective production decision making: (Jasmin Harvey, 2007)

For manufacturing industries with a very tough competition, one single wrong decision can lead into a complete disaster or worse to a business shutdown. Modern business manager become more interested to learn about managerial accounting even if they are not an accountant at first place. Also, there became and increasing dependence on financial reports, records, charts, financial trends to aid the managers in taking decisions regarding the cost, buying, selling, cut spending, short and long-term business goals.

- Future strategic business planning:

Strategic planning and managerial accounting are two interrelated subjects in business short- and long-term operating activity. An acronym used recently is strategic management accounting (SMA) defined as “the provision and analysis of management accounting data about a business and its competitors for use in developing and monitoring business strategy” (Simmonds. 1981)

Strategic planning always involves decisions, which later will be translated into an action plan, that will have a huge impact on the operating cost of the business (i.e., building new factory, expansion in production line, investing in R&D for innovating new product, shutting down an existing production line…etc), without knowing the actual current financial status of the company you are missing a main planning pillar and can lead to un-achievable un-realistic plan.

- Budgeting planning

With the ever-changing environment for the business, it became very unlikely for manufacturing company to survive by simply keep doing and repeating the same old plans and techniques from last years, the least to say is these old techniques became obsolete and exposed to the competitors, their comes the need for continuous updated strategic planning. Companies keep setting and adjusting their strategic plans depending on expected economical, competitiveness, technological advancement. With the strategic plan, then comes the SWOT analysis and action plans with KPI's which requires for the implementation a well-prepared financial resource. Without clear understanding for the company financial capabilities, cash flow and liabilities it would be impossible to clearly decide on development and company strategic objectives and the implementation for the plan can be non-effective.

Budgeting is a process involves setting plans for future income and expenses and setting a guideline for the company different department when setting plans and functional objectives.

- Variance analysis

When production of goods starts, it became the moment of truth. The real cost of product very likely will be different than what planned, and usually higher than the expected due to different reasons. Like planning for staffing assuming some level of production capacity but latter the production much lower which means the fixed production overhead would be

higher per product cost. Managing accounting, provide a systematic framework for splitting differences from expected cost of production into price and quantity variances enable the decision maker to clearly sees and feels the loses behind variance costing.

- Special sales order

For a manufacturing companies, the sales prices for any of the product they are producing is a sensitive and critical topic which usually takes the most time in discussion. It’s the red line between failure or success, eventually companies are supposed to create some profits out of the business by adding a profit margin on top of the product cost, so we should be able to decide precisely what the product cost. of-course any expenses paid direct or indirect in any form is supposed to be considered in the cost calculation formula, but that just only at the start-up of the business and during planning for production capacities and during deciding wither the company operating at MTS (manufacture to stock) or MTO (manufacture to order) style. But then come the real market challenges and chances. In many different cases a special sales order comes with a price lower than what originally have been set by the company for their product, special sales order is a onetime customer order involving large quantities and low price (Kenneth Boyd. 2016), but that doesn’t mean necessarily a rejected sales order, it could be YES and accepted if satisfying the basic main special orders conditions:

- Already have excess production capacity
- No change on fixed cost expenses
- The special sales order covers the variable cost only with extra margin

With accounting managing and splitting income statements showing the fixed and variable cost of product, it can support the decision of accepting or rejecting the special sales orders.

8. Conclusion

With many factories building their operation and keeping their focus only on production ignoring supporting services like managing accounting, leading to a blind surfacing in the market and lacking the functional tools and techniques for evaluating company performance and unfortunately with most of the cases a failure and poor decision making

The companies need on continuous and periodically review their financial operational status. Balance statement, Cashflow statement, Income statement are all providing complete guide and picture for the company health and wellbeing. managers are using the financial statement for hard and critical decisions could involves expansions in business or partial shutting down of some non-profitable and adding non-added value cost to the product.

With the income statement, the company manager became able of deciding on proper product pricing and accepting or rejecting any special sales order. The market is very competitive, and companies need to be agile and flexible and objective with evidence to any decision they take.

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