COVER PAGE AND DECLARATION

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Introduction:

Managerial accounting is the process of "identification, measurement, analysis, and interpretation of accounting information" that helps business leaders make sound financial decisions and efficiently manage their daily operations, according to the Corporate Finance Institute.

Main Body:

Case Scenario

Swipe 50 limited manufactures a specialized screen protector for laptops computers. The
plus, swipe is a screens protector that prevent scratches on laptop screens. The company
has been in operation for 3 years and now that company has refined its production
process, the directors have decided to focus on the income and cost arising from the
activities. Therefore, the CFO, Tamara J. Blooms, wants to focus on product costing. She
wants to look into how both absorption and variable costing affect the profits of the
company. The following information is available for the month February and March:

	February	March
Production (units)	12,500	14,500
Sales (units)	11,500	15,500
Direct Materials	€ 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

Additional Information

1. Swipes 50 Ltd. production capacity 20,000 units per month.
2. Fixed production overheads are €28,600 per month.
3. Swipe 50 sells Plus Swipes at €22 each.
4. On 31st January, the company's warehouse has no Plus Swipes in inventory.
5. Fixed and variable elements (variable portion is incurred based on units sold) are included in the total administration expenses.

Assignment Instructions

Please create a report for 50 swipes limited and please include the following in your report.

1. Prepare profit statement for Swipe 50 Limited for the month of February and March using:

a. Absorption costing

b. Variable costing

2. Reconcile the profit calculated using absorption costing to that using variable costing.
3. Explain how each method differs from the other method and also explain the importance of each methods.
4. Explain three ways that Swipes 50 Ltd. can improve its accounting systems.
5. State why managing accounting jobs are important in a manufacturing company.

<u>Required:</u>

1. Prepare profit statement for Swipe 50 Limited for the month of February and March using:

a. Absorption costing

b. Variable costing

Result

first: Absorption Method:

a) (February):

- Total manufacturing cost = 29,000+19,000+7,300 = 55,300/12,500 = 4.424 variable manufacturing cost per unit
- Variable selling and administrative expenses per unit = 44,500 -57,100 = 12,600/(11,500-15,500)=3.15
- Total variable selling and administrative expenses = 11,500 x 3.15= 36,225
- Total fixed selling and administrative expenses = 44,500 – 36,225 = 8,275
- Fixed production overhead per unit = 28,600/20,000=1.43
- Variance = 20,000 – 12,500 = 7,500 x 1.43 = 10,725
- Manufacturing cost per unit = Variable Manufacturing cost per unit + fixed manufacturing cost per unit = 4.424 + 1.43 = 5.854

Income statement – February (Absorption)

Sales (11,500 unit x 22) (-) COGS: Beg. Inv. 0 + Production (12,500 unit x 5.854) - End. Inv. (1,000-unit x 5.854)	 0 73,175 (5,854)	253,000
COGS		**(67,321)**
Gross margin (unadjusted)		185,679
+ Production volume variance = (7,500-unit x 1.43)		10,725
Adjusted Gross margin		**196,404**
(-) Operating cost: Variable selling and administrative expenses (11,500 x 3.15) = 36,225 Fixed selling and administrative expenses = (44,500 – 36,225) = 8,275	 36,225 8,275	
		(44,500)
Operating income		**151,904**

b) (March):

- Total manufacturing cost = 33,250+22,000+8,500 = 63,750/14,500 = 4.396 variable manufacturing cost per unit
- Variable selling and administrative expenses per unit = 44,500 -57,100 = 12,600/(11,500-15,500)=3.15
- Total variable selling and administrative expenses = 15,500 x 3.15= 48,825
- Total fixed selling and administrative expenses = 57,100 – 48,825 = 8,275
- Fixed production overhead per unit = 28,600/20,000=1.43
- Variance = 20,000 – 14,500 = 5,500 x 1.43 = 7,865
- Manufacturing cost per unit = Variable Manufacturing cost per uint + fixed manufacturing cost per unit = 4.396 + 1.43 = 5.826

Income statement – March (Absorption)

Sales (15,500 unit x 22) (-) COGS: Beg. Inv. (1,000-unit x 5.854) + Production (14,500 unit x 5.826) - End. Inv. 0	 5,854 84,477 0	341,000
COGS		**(90,331)**
Gross margin (unadjusted)		250,669
+ Production volume variance = (5,500-unit x 1.43)		7,865
Adjusted Gross margin		**258,534**
(-) Operating cost: Variable selling and administrative expenses (15,500 x 3.15) = 48,825 Fixed selling and administrative expenses = (44,500 – 36,225) = 8,275	 48,825 8,275	
		(57,100)
Operating income		**201,434**

Second: Variable Method:

Income statement – February (Variable)

	February	
Sales	11,500 x 22	253,000
(-) Cost of goods sold (v.) Beg. Inv. + Production (12,500 unit x 4.424) - End (1,000-unit x 5.854)	 0 55,300 (5,854)	
Cogs		**(49,446)**
+ Production volume variance = (7,500-unit x 1.43)		10,725
Adjusted Gross margin		**214,279**
(-) Variable selling and administrative expenses	(11,500 x 3.15)	(36,225)
Contribution margin		**178,054**
(-) Fixed Manufacturing cost	(11,500 x 1.43)	(16,445)
(-) Fixed selling and administrative expenses		(8,275)
Operating income		**153,334**

Income statement – March (Variable)

	March	
Sales	15,500 x 22	341,000
(-) Cost of goods sold (v.) Beg. Inv. + Production (14,500 unit x 4.396) - End	 5,854 63,742 0	
Cogs (unadjusted)		**(69,596)**

+ Production volume variance = (5,500-unit x 1.43)		7,865
Adjusted COGS		(61,731)
Gross margin (adjusted)		**279,269**
(-) Variable selling and administrative expenses	(15,500 x 3.15)	(48,825)
Contribution margin		**230,444**
(-) Fixed Manufacturing cost	(15,500 x 1.43)	(22,165)
(-) Fixed selling and administrative expenses		(8,275)
Operating income		**200,004**

Required:

2. Reconcile the profit calculated using absorption costing to that using variable costing.

Result:

February

(operating income under absorpt. – op. income under variable) = (Fixed manuf. Cost of end inventory under absorpt. – F.Manuf. of beg. Inv. Under absorpt.)

151,904 - 153,334 = 1000 x 1.43 - 0

(1430) = (1430)

March

201,434 - 200,004 = 0 – 1000 x 1.43

1430 = 1430

Conclusion

Difference in income are resulted from fixed element of manufacturing cost to inventory under each

Required:

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

Result:

Absorption costing and variable costing are methods used to value companies' work in progress and inventory, for accounting purposes. Absorption costing includes all the costs associated with the manufacturing of a product. Variable costing includes the variable costs directly incurred in production and none of the fixed costs. For reporting purposes, absorption costing is required under the Financial Accounting Standards Board's Generally Accepted Accounting Principles (GAAP).

Absorption vs. variable costing will only be a factor for companies that expense costs of goods sold (COGS) on their income statement.

Although any company can use both methods for different reasons, public companies are required to use absorption costing due to their GAAP accounting obligations.

KEY TAKEAWAYS

- Absorption costing includes all of the direct costs associated with manufacturing a product.
- Variable costing can exclude some direct fixed costs.
- Absorption costing entails allocating fixed overhead costs to all units produced for an accounting period.
- Variable costing includes all of the variable direct costs in COGS but excludes direct, fixed overhead costs.
- Variable costing can provide a clearer picture of per-unit cost and inventory value because it excludes the fixed overhead cost.

Direct and Indirect Costs

Before looking at absorption versus variable costing, it's important to understand the difference between direct and indirect costs on the income statement. Direct costs are usually associated with COGS, which affects a company's gross profit and gross profit margin. Indirect costs are associated with the operating expenses of a company. These costs heavily influence operating profit and the operating profit margin.

Some of the direct costs associated with manufacturing a product include wages for workers physically manufacturing a product, the raw materials used in producing a product, and direct overhead costs involved in manufacturing a product.

Indirect expenses are not directly associated with manufacturing. These can include:

- Research and development
- Some depreciation
- Amortization of intangibles
- Selling expenses
- Marketing expenses
- Administrative expenses
- Other expenses

Absorption Costing

Absorption costing is also known as full costing. Public companies are required to use the absorption costing method in cost accounting management for their COGS.

Many private companies also use this method because it is GAAP-compliant whereas variable costing isn't.

Absorption costing involves allocating all of the direct costs associated with manufacturing a product to COGS. This includes any variable costs directly associated with manufacturing, such as:

- Cost of raw materials

- Hourly cost of labor
- Salaries of manufacturing workers
- Variable costs of electricity used to run a plant in manufacturing mode

This also includes any direct fixed costs, such as:

- The mortgage payment on a building used for manufacturing
- Insurance on a manufacturing property
- Depreciation on a manufacturing machine

Depending on a company's level of transparency, an income statement using absorption costing may break out variable direct costs and fixed direct costs into two line items or combine them together to report a comprehensive COGS. In any case, the variable direct costs and fixed direct costs are subtracted from revenue to arrive at the gross profit.

Using the absorption costing method will increase COGS and thus decrease gross profit per unit produced.

This means companies will have a higher breakeven price on production per unit. It also means that customers will pay a slightly higher retail price. Furthermore, it means that companies will likely show a lower gross profit margin.

The impact of absorption costing will depend on the business. For example, a company has to pay its manufacturing property mortgage payments every month regardless of whether it produces 1,000 products or no products at all. A company may see an increase in gross profit after paying off a mortgage or finishing the depreciation schedule on a piece of manufacturing equipment. These are considerations cost accountants must closely manage when using absorption costing.

The absorption costing method is typically the standard for most companies with COGS. It is required for compliance with GAAP. Auditors and financial stakeholders will require it for external reporting. Depending on the

type of business structure, small businesses may also be required to use absorption costing for their tax reporting.

A main advantage of absorption costing is that it is GAAP-compliant.

That means that's the only method needed if it's what a company prefers to use. If a company prefers the variable costing method for management decision-making purposes, it may also be required to use the absorption costing method for reporting purposes.

Variable Costing

Some companies may choose to use the variable costing method. With variable costing, all of the variable direct costs are included in COGS. The fixed direct costs are allocated to operating expenses rather than COGS.

The types of fixed direct costs are the same whether a company uses absorption or variable costing:

- A mortgage payment on a building used for manufacturing
- Insurance on a manufacturing property
- Depreciation on a manufacturing machine

Variable costing will result in a lower breakeven price per unit using COGS. This can make it somewhat more difficult to determine the ideal pricing for a product. Variable costing results in gross profit that will be slightly higher. In turn, that results in a slightly higher gross profit margin compared to absorption costing.

Keep in mind, companies using the cash method may not need to recognize some of their expenses as immediately with variable costing since they are not tied to revenue recognition. This can be an advantage.

The reason variable costing isn't allowed for external reporting is because it doesn't follow the GAAP matching principle. It fails to recognize certain

inventory costs in the same period in which revenue is generated by the expenses, like fixed overhead.1

Key Differences

Both costing methods can be used by management to make manufacturing decisions. For internal accounting purposes, both can also be used to value work in progress and finished inventory. The overall difference between absorption costing and variable costing concerns how each accounts for fixed manufacturing overhead costs.

Here's a summary of their differences.

	Absorption Costing	Variable Costing
Method	Applies all direct costs, fixed overhead, and variable manufacturing overhead to the cost of a product	Only variable costs are applied to the cost of a product; fixed overhead costs are expensed in the period in which they occur
Use	Calculates a per-unit cost of fixed overhead	Determines a lump-sum for fixed overhead costs
Inventory	Inventory value includes direct material, direct labor, and all overhead	Inventory value does not include fixed overhead
Accounting	Can cloud picture of company profitability for an accounting period because all fixed costs are not deducted from revenues (unless all inventory is sold)	Doesn't match expenses to revenue (with regard to inventory) in the same accounting period; may result in a more realistic inventory value and actual profit since unsold stock doesn't absorb fixed overhead costs
Reporting	Acceptable costing method under GAAP	Not an acceptable costing method under GAAP

Conclusion

Absorption costing entails allocating fixed overhead costs to all units produced for an accounting period. Variable costing includes all of the variable direct costs in COGS but excludes direct, fixed overhead costs.

Required:

4. Explain three ways that Swipes 50 Ltd. can improve its accounting systems.

Result:

Since the accounting team and its functions are certainly here to stay, we've decided to push out a list of tips to at least make the accounting department more efficient, more productive, and more conducive to business-wide success.

1. Be timely with reconciliation.

No, you may not have to do it now, but reconciling accounts payable and accounts receivable to your statements of financial position and your balance sheet will be much easier a little at a time, at the end of each month. The alternative (reconciling at fiscal year end all at once) certainly sounds awful.

2. Put cutoff policies in place and stick to them.

We've mentioned this tip before, but it's important to have a system of rules and cutoffs for submitting invoices, reimbursements, etc. and strictly enforce them. Business rules drive the accounting processes and must be adhered to.

3. Research is not a waste of time, ever.

Sometimes it's hard to justify sitting and reading for an hour or two on the job, but it is absolutely necessary in accounting. Laws and tax forms change, and best practices are constantly being improved on.

Conclusion

A company that fails to keep an accurate record of its business transactions is more likely to operate inefficiently and may lose revenue in the long run. Accounting systems help business owners and their managers to measure business growth in terms of profitability accurately.

An effective accounting system is accurate, useful and timely. Its purpose is to provide information for external entities, such as tax agencies and investors, and for internal purposes, such as evaluating efficiency and profitability.

Required:

5. State why managing accounting jobs are important in a manufacturing company.

Result:

The reason for the emergence of management accounting

The concept of management accounting developed during the industrial revolution in the nineteenth century. During that period, most companies were owned and operated by a few directors. Detailed financial reports were not requested as there were no external shareholders. The twentieth century saw a lot of changes in the economy. Firms had to submit detailed financial reports in order to meet capital markets, tax purposes and creditors (Seal, W et al., 2006). Earlier, the production technology was simple, as the products went through a series of distinct production stages. Therefore, it was easier to determine the associated material and labor costs, and thus direct labor was used as a basis for assigning indirect costs to products (Ashton, D et al., 1995).

Management accounting concept

The management accountant is usually responsible for achieving the management objective of the company. Tasked with managing and tracking incomes and expenses, these professionals' duties may extend to assisting companies with internal operational accounting work such as payroll, tax and asset management.

The importance of management accounting

Accounting activities help administrators make important decisions regarding the operation of a business. Accounting areas such as financial reporting,

budgeting, and cost information help managers make planning and control decisions. Executives use the information provided by accountants to determine the financial health of the company and the organizational resources needed to operate. Among the functions of management accounting we find:

Submit a financial report

Financial reporting is one of the essential aspects of financial accounting. Accountants compile financial statements and other financial documents for presentation to company managers. Financial reporting is important to the administrator because it shows the amount of business profit or loss. Officials and other members of the executive management team use the information presented in financial reports to make decisions about the need to borrow money, increase rates, reduce expenses, or other financial matters. Some companies choose to show their management's view of the organization's financial performance in a section of their financial statements called

Management Discussion and Analysis of Financial Condition and Results of Operations.

Planning and control Accounting can help the administrator in making planning decisions related to the organization. Planning includes defining organizational goals, developing strategies to achieve the goals, and determining the resources needed. Management accounting provides managers with information that allows them to determine the effectiveness of past decisions and what decisions need to be made in the future. Measuring the effectiveness of planning decisions is called control. Some small businesses use a controller, which oversees the entire planning and control practices of the organization.

Determine budget needs Accounting also helps the administrator determine the company's budget needs.

Management accountants and budget analysts typically develop budgets for each department within a company and an overall organizational budget. Managers approve developed budgets. Budgets are important because they help the administrator in determining whether the company is achieving its organizational goals with the resources allocated. Managers compare budgets with actual performance to determine whether the company is under budget or over budget. An administrator may decide to cut out certain programs or services within an organization that do not fit within the budgets established by accountants.

Costing

Cost accounting is another discipline in the accounting industry that helps an administrator make important decisions. Cost accounting involves dividing costs into specific categories, and then assigning costs to a specific product or service. The administrator can also determine the cost associated with certain activities and determine if the company can reduce certain costs. An administrator can use the information produced by cost accountants to determine whether a particular product is profitable. For example, an administrator may decide to cancel the manufacture of a particular product if it is determined that the revenue and profits generated by the product cannot justify the costs incurred on producing it.

Product cost and evaluation

Product costing deals with determining the total costs involved in producing a good or service. Costs can be divided into subcategories, such as variable, fixed, direct, or indirect costs. Cost accounting is used to measure and determine those costs, as well as to allocate overheads to each type of product that a company has created.

Management accountants calculate and allocate overhead fees to assess the full expenses related to the production of a good. Overheads may be allocated based on the number of goods produced or other activity drivers related to production, such as the square feet of the facility. In conjunction with overhead costs, management accountants use direct costs to properly assess the cost of goods sold and inventory that may be in various stages of production.

marginal cost

It is the effect on the cost of a product by adding one additional unit to production. It is useful for short-term economic decisions.The contribution margin for a particular product is its effect on the company's overall profit. Margin analysis flows into break-even analysis, which involves calculating the contribution margin to the sales mix to determine the unit size at which the company's total sales are equal to total expenses. Break-even point analysis is useful for determining price points for products and services.

cash flow analysis

Management accountants perform cash flow analysis in order to determine the monetary impact of business decisions. Most companies record their financial information on an accrual basis of accounting. Although accrual accounting provides a more accurate picture of a company's true financial position, it also makes it difficult to see the true monetary impact of a financial transaction.

unit. The management accountant may implement working capital management strategies in order to improve cash flow and ensure that the company has sufficient liquid assets to cover short-term liabilities.

Inventory turnover analysis

Inventory turnover is a calculation of the number of times a company has sold and replaced inventory in a given period of time. Calculating inventory

turnover can help companies make better decisions about pricing, manufacturing, marketing, and purchasing new inventory. The management accountant may determine the book cost of inventory, which is the amount of expenses a company incurs to store unsold items. If a business is carrying an excessive amount of inventory, there may be efficiency improvements made to reduce storage costs and free up cash flow for other business purposes.

constraint analysis

Management accounting also includes a review of limitations within the production line or sales process. Management accountants help identify where bottlenecks occur and calculate the impact of those limitations on revenue, profits, and cash flow. Managers can then use this information to implement changes and improve efficiencies in the production or sales process.

Budget analysis and forecasting

Budgets are widely used as a quantitative expression of a company's business plan. Management accountants use performance reports to note deviations of actual results from budgets. Positive or negative deviations from the budget, also referred to as variances between budget and actual, are analyzed in order to make appropriate changes in the future.

Eclectic nature

Management accounting identifies only a few information out of the many that the financial accounting system provides. The reason is that all financial accounting information is not necessary for management.

Focus on the future

There is no sense in collecting historical data. Management accounting tries to highlight what should have been. In this aspect, it emphasizes the use of

standard costing, cost variances, and budgetary control to highlight the future nature of management accounting.

provide information

Financial accounting information is presented on different bases and in a different manner which helps management to plan soundly and make quality decisions. It is up to the intelligence of the management executives to make a correct decision from the available information.

Studying the relationship between causes and effects

Under financial accounting system, Profit and Loss Account is prepared to find out the amount of profit earned or loss incurred. It does not disclose the reasons for the amount of profit gained or loss incurred. But under the management accounting system, it studies the relationship of cause and effect between the variables that affect business activity and profitability through analysis.

Recognition of non-monetary variables

Non-monetary variables such as employee efficiency, labor turnover, management policy, organization culture, market conditions, consumers or customer behavior are taken into consideration before a decision is made by management. Under these circumstances, management considers monetary information to support its decisions.

Modify, analyze and interpret data

Management accounting information is modified, analyzed and interpreted in new dimensions. In this way, the data helps management take a course of action towards controlling the fate of the undertaking.

achieve goals

Management accounting fixes the standard for various business activities on the basis of historical information provided by financial accounting. Actual performance is recorded for comparison between actual and benchmark performance. In case of any deviations, corrective actions can be taken by the management to achieve the objectives.

improve efficiency

The management can set the target for each department through the budget control system. Actual performance is compared to goal performance. Deviations are detected and categorized into two categories, positive deviations and negative deviations. If the deviations are positive, the concerned department is appreciated. In case of negative deviations, the reasons are discovered to give ideas to improve the efficiency of the relevant management. In this way, the efficiency of the employees in the organization as a whole is improved.

Source accounting control

The performance of individual workers, details of materials, usage of services like machine, power, repairs, maintenance, vehicles, etc. are prepared in the form of quantitative and qualitative information. In this way, control can be exercised over personnel, materials, and service provisioning devices.

Accounting for inflation It cannot be said that profit can be made unless capital is kept intact in real terms. This means that the financial value is not stable. Hence, it is necessary to evaluate the value of capital contributed by business owners in terms of real value of money through revaluation accounting. In this way, the inflation rate is taken into account to judge the true success of the business.

Use of return on investment

The return on investment is otherwise called the return on capital employed. The rate of return shows the efficiency of the business interest. For this purpose, the capital employed is calculated in terms of real cash value.

resource usage Available resources must be used effectively. The reason is that some resources are only available in abundance for logical reasons and some others are available in scarcity throughout the year. Hence, the management accounting system must ensure proper use of available resources.

a future vision

The management accounting system can guess future problems through standard costing techniques by defining the standard. In this way, the future problem may be prevented from occurring.

Conclusion

Management accounting helps small-business owners determine which products they should be in the habit of manufacturing in the first place. Manufacturing firms often have discretion in determining whether to build a product from scratch or to buy certain components of the product preassembled.

Essentially, managerial accountants provide key insights that help a company's management team make many of their decisions. They also support decision making within a company by providing a wealth of financial and statistical information, often assisted by powerful accounting software.

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