

Managerial accounting

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## 1.0 Introduction

Managerial accounting is the connection between financial accounting and the top management regarding to the flexibility of roles and the simplicity of presentation.

As long as managerial accounting techniques are not dictated by financial accounting standards the managerial accounting encompass many facets of accounting production's costing, budgeting , forecasting and various kind of analysis the managerial data can be modified and edited to meet the internal requires of the management and the end user of reports the main aim of the managerial accounting is to improve the information's quality about business operations metrics using information about cost, sales and revenue .

Cost accounting is a large part of managerial accounting it allows to identify, allocate and reduce unnecessary costs and maximize profit.

Using a different kind of analysis like

- 1- Production and cost valuation
- 2- Cash flow analysis
- 3- Inventory turnover.
- 4- Accounts receivable management
- 5- Budgeting and forecasting

To finalize the reports and analysis needed for business and top management.

Upcoming we are going to present the reports of February and march for fifty swipes company.

## 2.0 profitability report

Profitability is the main target of all business kind that every company focus on how to maximize it by using a lot of ways like cost controlling or expenses reduction.

Regarding to the production's data and the expenses in February and march we are going to analyse and prepare the profitability reports using two methods of costing accounting.

- 1- Absorption costing
- 2- Variable costing

The absorption costing method differs from variable costing.

- 1- It is allocated fixed overhead to each unit of product produced in the period.
- 2- It is allocated fixed overhead to product whether sold or not during period.

That means more cost is included in ending inventory and less in the income statement.

The next table will explain the different between both methods.

Absorption costing		Variable costing
Product cost	Direct material	Product cost
	Direct labour	
	Variable manufacturing overhead	
	Fixed manufacturing overhead	Period cost
Period cost		
	Variable sales and administrative	
	Fixed sales and administrative	

Regarding to the information about the production during February and March

Absorption costing method.

	February	unit cost	march	unit cost
production	12,500.00		14,500.00	
direct material	29,000.00	2.32	33,250.00	2.29
direct labour	19,000.00	1.52	22,000.00	1.52
variable production over head	7,300.00	0.58	8,500.00	0.59
fixed production over head	28,600.00	2.29	28,600.00	1.97
total unit cost		6.71		6.37

The COGS = Sales units X unit cost

Feb COGS = 11500 X 6.71 = 77165

March COGS = 1000 X 6.71 + 14500 X 6.37 = 6710 + 92365 = 99075

Sales value = sales units X unit price

Feb sales = 11500 X 22 = 253000

March sales = 15500 X 22 = 341000

Profitability using absorption costing.

Regarding to absorption costing we can see the profit and loss short statement.

	February	March
Sales	253,000.00	341,000.00
COGS	77,165.00	99,075.00
Gross margin	175,835.00	241,925.00
Total Selling and Administrative Expenses	44,500.00	57,100.00
Net margin	131,335.00	184,825.00

Regarding to the variable costing method the cost will count as the below table.

	February	unit cost	marc	unit cost
production	12,500.00		14,500.00	
direct material	29,000.00	2.32	33,250.00	2.29
direct labour	19,000.00	1.52	22,000.00	1.52
variable production over head	7,300.00	0.58	8,500.00	0.59
total unit cost		4.42		4.40

Feb COGS = 11500 X 4.42 = 50830

March COGS = (1000 X 4.42) + (14500 X 4.4) = 4420 + 63800 = 68220

Profitability reports using variable costing.

	Feb	March
Sales	253,000.00	341,000.00
COGS	50,830.00	68,220.00
Gross margin	202,170.00	272,780.00
Fixed Production Overhead	28,600.00	28,600.00
Total Selling and Administrative Expenses	44,500.00	57,100.00
total period exp	73,100.00	85,700.00
net margin	129,070.00	187,080.00

We can notice that when using two diverse ways to calculate the cost the result of the profit statement will change regarding to the way.

### 3.0 Reconcile the profit statement.

Is to find the differs between the two methods.

So, when we see February's result, we will see that the cogs while using Absorption is higher than cogs while using the variable cost by  $(77165-50830) = 26335$

Which is 2.29 by the pc and it is the differ in the unit cost regarding to the fixed production overhead.

Also, if we look at the ending inventory, we will find the variance of 2290 which will be allocate to the next period cost.

The net margin of FEB while using the absorption is higher than net margin using the variable regarding to the higher of the ending inventory.

The variance in net margin =  $131335 - 129070 = 2265$

The value of variance in over heads =  $28600 - (2.29 * 11500) = 2265$

Which the part of the fixed production overhead allocated to the next month

While the net margin of march is higher when using variable cost method by

$187080 - 184825 = 2255$

Which is the variance of allocating the fixed production over head to the product cost and the value of last month overheads which we save in the absorption cost.

### 4.0 the difference between the two methods

Absorption and variable costing are both used to value companies cogs and inventory the absorption method include all the costs associated in the production while the variable costing includes only the variable costs and exclude all the fixed.

Also, the absorption method is required under the GAAP.

- Variable costing gives a clear picture of unit cost and inventory.
- Absorption costing also calls full costing because it includes all direct costs like
  - 1- Raw materials

2- Hourly salaries

3- Utilities

4- Includes indirect costs overhead like depreciation of machines.

- Using of absorption costing method will affect the gross margin by increasing the COGS.
- Absorption costing method is fully commit to the GAAP and using in external financial reports.
- Variable costing is chosen by some companies to have a better break-even price.
- When using variable costing the cogs only includes the variable direct cost in unit cost and allocate other to the operating expenses

#### 4.1 advantage and disadvantage of each

1- Advantages of absorption costing method

- The main advantage is that the absorption method is fully comply with GAAP and required for reporting to the internal revenue services.
- Accounting all production costs because it takes in account all the cost of production not only the direct costs including the fixed costs to the production giving a complete picture of cost per unit for a product line which helping the management evaluate profitability.
- Tracking the profit because it is provided the company with accurate view about profitability particularly if all the production are not sold in the same period of manufacturing.

2- Disadvantages of absorption method

- Skewed the profit regarding to include all the fixed costs to the units so some of the period cost will move to the next period with the ending inventory which makes more periodic profitability.
- Does not influence the operational efficiency because if the fixed cost is sup of total, it will be difficult to determine the variances in cost.
- Not suited to product lines comparison

3- Advantages of variable method

- Offered a better understanding how the fixed costs affect the net profit.
- More control for the fixed cost
- Provide more data about the cost volume profit.

- Helps in operation planning.
  - Budgeting: most of manufacturers depends on variable cost in budgeting
- 4- Disadvantages of the variable method
- It is not a GAAP compliant.
  - Cannot use in external reports.: tell now all the external reports or tax reports not accepting the variable cost.
  - Long term pricing: it is ineffective in long term pricing because it does not count the factory fixed cost.

Here we can give a summery for the differences.

Absorption costing method		Variable costing method	
Advantages	Disadvantages	Advantages	Disadvantages
The main advantage that its compile to the GAAP	Skewed the profit	Offered a better understanding how the fixed costs affect the net profit.	Not compline with GAAP
More accurately track profit	Does not influence the operational efficiency	More control for the fixed cost	Hard to use in external reports
Accounts for all production costs in the period	Not suited to product lines comparison	Provide more data about the cost volume profit.	Not effective for long term pricing

### Importance of the absorption costing

The importance of the absorption costing comes from the compliant with GAAP which means that any company must do it for the external reports as many countries tax's law requires the using of the absorption cost even full absorption or approach also while its give high value of net margin in case there is ending balance inventory which makes the company valuation is much more high regarding to this method all the expenses relating to the production allocated to the units which gives more cost accurate and a clear COGS value

Also, the absorption costing as valuation method for inventory it is increases the profit of the company.

## Importance of the variable costing

- Makes an informed decision making by the right way in calculate the cost of unit without add any fixed overheads allowing the company to take a good decision depending on the right information about the cost and expenses also it gives a right valuation of inventory.
- Monitoring the variable expenses while calculating the unit cost by only the variable expenses we can track and monitor how much is the change in prices and cost regarding to the unit not the value of production.
- Make a realistic and fair sales goals while using this way the gross margin is determine clearly regarding to the unit variable cost only also the other fixed expenses are calculated so the company can clearly see the profit and make sales targets more realistic.
- Prevents the mistakes in pricing costs of units:
- Easily to find the break-even point accurately.
- Helping in analyse of the various kind of cost and expenses.

## 5.0 improving the accounting system.

How can the companies improve the accounting system?

At the beginning we must know what the accounting system is and how it works

The accounting system is divided to a various phases and steps like

- Data collecting
- Recording
- Auditing
- Reporting

Every step inside the system has a lot of roles, regulations, and procedures to complete the step and phase requires and reach the goal to deliver a high quality of work and efficiency.

all steps sharing the same goals at the end to help the management and decision makers to take the right action towards the right directions.

to improve the accounting system, we need to improve each step by itself.

- 1- Collecting data

so, while we are collecting the data, we must make sure that all documents are collected.

the documents must be confirmed from the authorised person.

Each kind of document must allocate to the right sub-department inside the accounting and finance department.

## 2- Recording and archiving

The recording of financial and accounting transaction is a sensitive because all accounting reports depend on the data records so at the beginning the accounting department must be structured to fit the organization workflow.

For our company, the good structure is like

- 1- Cost accounting
- 2- Accounts payable
- 3- Accounts receivable
- 4- General accounting
- 5- Auditing

Each department of this must be responsible about some kind of transactions the most important department is the costing this department will deal and involve with production and operations departments.

The most major step for improving and controlling is using ERP system in accounting for recording and archiving.

Also keeping a soft copy of all documents makes more control.

All communications and orders must be done by official ways like emails tasks software etc,

The expenses must be reviewed to be allocated to each department the cost department is responsible for allocating it which is managerial or operational cost.

Also using cost center will make it more accurate to allocate the expenses even if we divide the production area to cost centers if we do this it will give a big chance to enhance some expenses regarding to the production overheads and direct cost.

Start preparing budgets and plans expected production and sales will give a pre situation about the financial performance and what we will need to take in consideration about raw material and the cashflow trend for the company which can give us a clear view for what is next.

### 3- Auditing

The auditing process is requiring for controlling everything regarding to accounting also to avoid any miss data or wrong allocation during the accounting period.

The auditing team must be independence.

### 4- Reporting

Which is the final and the result of all the previous steps this process must be unique.

Various kind of reporting must be added to the system for more accurate and analysis.

To have all the previous steps improving and developed we have an incredibly good tip for it.

#### 1- Staff training

Always we must train the accounting department for the innovative technologies and methods.

#### 2- Use analysis software.

Like power BI and more like this we can use in data analysing to get a faster and more professional results

#### 3- Operate every task as a project and manage it.

#### 4- Always getting feed back from the team

Getting feed back from the team helping us to know the micro-problems inside the department and give more friendly communication between all the team.

#### 5- Standardize the workflow.

Implement roles and regulations inside the department – prepare workflow with Quality standards.

#### 6- The last step is to evaluate all our work at the end of each period to see the following of standards level, checking if there is a missing training for the team or we need to hire new members to accomplish the work on time with the require quality.

## 6.0 important of managerial accounting jobs

The role of the managerial accounting inside the manufacturing companies is key role regarding to what is the results and reports we will get from it.

This role is divided to many sub-roles.

### 1- Current costing calculating

This is to help the company and inform the top management about which product is profitable and if we need to enhance some thing about the products.

### 2- Planning for the new products

The managerial accounting is a supportive role in planning for a new product helping the company starting from the cost calculation tell monitoring the productions steps.

Breaking down all the steps from the capability of production, product cost, markets comparison

### 3- Budgeting

Managerial accounting helping in budgeting and planning for the production capacity and costing and expecting expenses.

### 4- Performance evaluations

This one of the most key factors in managerial accounting using to monitoring the production and cost.

Managerial accounting must include all the financial and non-financial information to the evaluation.

### 5- Maximizing the profitability

By controlling the cost of production, monitoring the inventory, and controlling the capacity of production managerial accounting helps the company to maximize the profitability.

### 6- Strategic analysis

By giving the right reports and good data analysis managerial accounting can affect the strategic plans by changing the perspective regarding to the information's

### 7- Helping in decision making

By giving the information to the top management which helps them to take the right decision about the products and production

## 7.0 conclusions

At the end we have to say that managerial accounting is too much important part of the financial department completing all the financial flow and keep a very good eye for costing and production we can consider the managerial accounting is the link between financial, accounting and all other departments since it work closely with the other departments in collecting data and delivering reports

## 8.0 References

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