

Management Accounting

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Introduction

Management accounting plays a very important role in making a company strong and functional. It helps the company in taking day to day decisions. The company chosen for analysis is The Pickup Trucks Company, which makes toy trucks. This company will be analysed for different aspects.

- 1. Need for investing in the latest software of management accounting as well as financial accounting, highlighting differences between management accounting and financial accounting.**

Management accounting

Management accounting is the field that is responsible for generating timely reports on statistics and financials of a company so that they can take up day to day decisions regarding the firm (Kimmel, 2004).

Financial Accounting

It is field of accounting which is responsible for the preparation of financial reports that are used to show the performance of an organization to the people who are not directly involved in the operations e.g. stakeholders. Moreover, financial accounting is the field which deals with the analysis of the whole financial transactions, statements, borrowing, spending and all other things that are concerned with the financials of a company. (Kimmel, 2004).

Differences between management accounting and financial accounting

Management accounting	Financial accounting
<ul style="list-style-type: none">• Provides a report for internal stakeholder• Gives a report of company's available cash, recent sales and revenues.• The reports are general to help for the future decisions• They are calculated on the base of informational needs of the management• Provides information for decision making for managers	<ul style="list-style-type: none">• Provides a report for the external stakeholders• The report is based on historical data• These reports are not confidential and can be used publically• They are based on accepted financial principles.• Provides information for decision making for all stakeholders e.g. investors, banks, creditors, government, directors and managers

1.3.1. Aggregation

Aggregation deals with taking in account the prospects which a business can exploit. It collects the information which can be used in the future in case of expansion.

For instance, in a project different types of computer has to be manufactured. The aggregate capacity management would take the total number of computers to be manufactured in next three months period. Without considering the composition of product mix with laptop and desktop computer and notepad.

1.3.2. Proven information

The reports of financial accounting have to be precise so that they can be used to prove the financials of a company. Management accounting reports use estimates to calculate and advice for the future.

1.3.3. Efficiency

Financial Accounting is responsible for the reports on the efficiency of business. The management accounting focuses on where the business is lacking and how to fix the problem (Kaplan,1982).

1.3.4. System

As explained by Kaplan, (1982) financial accounting has no direct connection with how profit is being generated it only focuses on how much the profit is. Management accounting is focused on the issues which are causing hurdles in the profit and ways these hurdles can be overcome.

1.4 Management accounting software

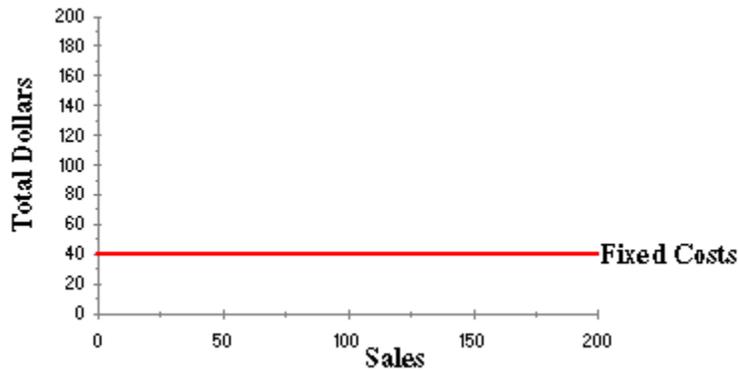
There are many accounting software available in the market nowadays. The management accounting software has many advantages over conventional ways of accounting. The main advantage is that of speed. Computerizing an accounting system makes it speedy. The software is more accurate and can provide information automatically. Management can be done in a better way if software is involved in the process, therefore with the development of computerized software, management accounting has become an easier, reliable and faster task (Epstein and Lee, 2011).

2. Importance of classifying costs on the basis of types, behaviour, function and relevance in business decision making, with suitable examples

2.1 Types of different costs

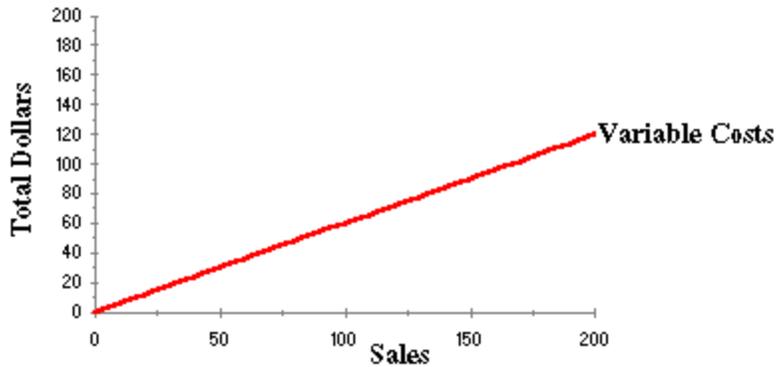
2.1.1. Fixed cost

Fixed cost is the cost that a company has to pay and it normally remains static as company overheads. This type of cost doesn't change or depend on the output of the business. Fixed cost is the cost of depreciation, plant, machinery, rent, building, interests, etc. (Drury, 2008).



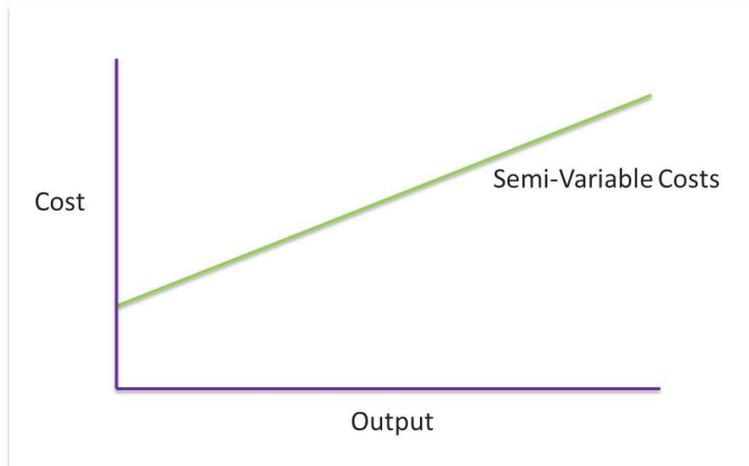
2.1.2. Variable cost

Variable costs are those that depend on the output of the business. These costs are dynamic and can change as the output increases. An example of variable cost is the pay of the employees, the expenditure on the raw material, etc.



2.1.3. Semi-variable cost

Semi-variable costs are those cost which is neither fixed nor variable. A part of these costs are fixed, and a part of them has to change with time. Depreciation can be counted as a semi-variable cost as it can change due to experiments was done on the property (Martinson,1970).

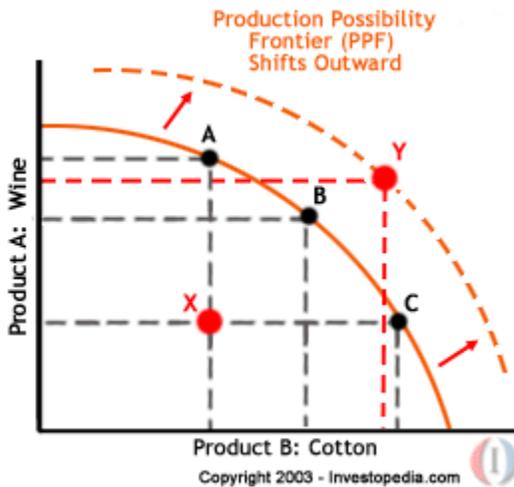


2.1.4 Actual cost

Actual cost is the cost that is invested in the production of the goods and other services. These costs include raw material cost, labour, and rents, etc. Actual cost is also known as the accounting cost as it is directly connected with the accounting data.

2.1.5 Opportunity cost

Opportunity cost can be defined as the cost that is expected to be gathered if a chance is taken. Opportunity cost is not predictable, but it is assumed at some stage. In businesses opportunity costs are also known as alternate costs through which the business can get any sort of benefits.



2.2 Importance of classification

It is very important to classify costs to differentiate. This classification can help in various ways. Classification of cost can help in the preparation of the budget. Through classification, a business can figure out exactly what amount of money to be spent and where. This way the company or business can easily devise its budget. Cost classification also helps in measuring the efficiency. Through this, costs are more visible for study and thus the efficiency of the business can easily be calculated. Another major factor in which the cost classification contributes is the cost controlling. When we talk about cost controlling it can further be divided into the control of sections like labour cost, material cost, overhead cost, etc. In the section of cost controlling all the costs that are made of these factors can be controlled and brought down to a level where they benefit the company. Classification of cost can also help in the expansion of the organization as it shows exactly where the money is being invested and by knowing this, the organization can

control the cost and once the cost is controlled the organization can further expand. Moreover, classification of costs makes it easier for accounting and produce accurate financial reports and data, if the costs are not classified appropriately the financial data may has discrepancies (Meigs, 1979).

Cost classification can also help in making decisions of a firm. If we take in considering that a company is planning to launch a new product. The classification of the costs and considering the analysis done through them the company can decide better whether it is feasible to launch the product or not. Another example of effective use of cost classification is when budgeting has to be done, the cost classification shows where exactly the investment has to be made so the budget can be as closely approximated as possible (Meigs, 1979).

3. Objectives of preparing budgets and provide examples for operational budgets.

3.1 Budget

Budget is something that is planned for a set period of time that takes in account all the expenditure that the business will do and the gains it will make. Aikin, Barbould, and Adams, (1855) briefly explained that Budgets are made for various reasons. These reasons are listed below:

3.1.1. Helps focus on goals

Budgeting plays a very important role in preventing people from wasting money. The final goal set at the end of the budget keeps them transfixed on saving up to achieve what they aim for.

3.1.2 Keeps money in check

Budgeting keeps the money in check. It prevents from excessive use of money and taking loans that a business can't pay in the long run. Budgets are important to keep check and balance on the money.

3.1.3. Prepare for emergencies

When a budget is made the money is divided into parts which are necessary for coverage. These divisions help to keep some money on aside for emergencies and plan accordingly.

Budgeting has many advantages. The basic reason for making a budget is to plan the spending of money in a way which can benefit the company or business. Budgeting can be done on small or large scales. These budgets help the companies in keeping a check and balance between every action that they take. Budgets help in generation of profit by keeping a check on the expenditure and preventing the waste of money on unnecessary things. Budgeting also gives a picture of what has to be done and how it has to be done to improve the future of the business(Stittle,2008).

3.2 Operational budgets

Operational budgets are those budgets that predict the income of the year taking into account a combination of expenses and the expected cost that will be spent in the future. These budgets require the estimated revenues and expenses. (Vargo,2015).

Sales

	<i>Quarter 1</i>	<i>Quarter 2</i>	<i>Quarter 3</i>	<i>Quarter 4</i>	<i>Total</i>
Units	15,000	17,000	28,000	40,000	100,000
Selling Price	<u>\$15</u>	<u>\$15</u>	<u>\$15</u>	<u>\$15</u>	<u>\$15</u>
Total Sales	<u>\$225,000</u>	<u>\$255,000</u>	<u>\$420,000</u>	<u>\$600,000</u>	<u>\$1,500,000</u>

**Example of
Budget**

Sales budget has simple components; basically it requires the management company to agree on exactly how many items are to be sold and at what price. The preparation of a budget is a time consuming process. The budgeting for the next year of Pickup Trucks Toy manufacturing Company has been set such that the items to be sold are decided to be 100,000 trucks and the price decided is \$15.00. Some monthly budgets are also made in addition to the annual and quarterly budgets which help in tracking sales with the expectations within less time than 3 months.

**Example of
Production
Budget**

Sales	15,000	17,000	28,000	40,000	100,000
Required Ending Inventory (¹)	<u>2,550</u> (²)	<u>4,200</u> (²)	<u>6,000</u> (²)	<u>2,475</u> (⁴)	<u>2,475</u> (⁵)
Units Required	<u>17,550</u>	<u>21,200</u>	<u>34,000</u>	<u>42,475</u>	<u>102,475</u>
Beginning Inventory	(<u>2,250</u>)(³)	(<u>2,550</u>)(²)	(<u>4,200</u>)(²)	(<u>6,000</u>)(²)	(<u>2,250</u>)(⁶)
Units to be Produced	15,300	18,650	29,800	36,475	100,225

The pickup trucks company quarterly makes its sale budget and before the quarter begins 15% of the volume has to be on hand. Analysis has shown that there is to be a 10% increase in the sales of the next year, therefore for the first quarter of the sale 2.250 units have to be available in the inventory.

**Example
Material**

	<i>Quarter 1</i>	<i>Quarter 2</i>	<i>Quarter 3</i>	<i>Quarter 4</i>	<i>Total</i>
Units to be produced (¹)	15,300	18,650	29,800	36,475	100,225
Number of tires per unit (²)	<u>×5</u>	<u>×5</u>	<u>×5</u>	<u>×5</u>	<u>×5</u>
	76,500	93,250	149,000	182,375	501,125
Required ending inventory (³)	9,325	<u>14,900</u>	<u>18,238</u>	<u>8,415</u> (⁴)	<u>8,415</u>
Total units required	85,825	108,150	167,238	190,790	509,540
Beginning inventory (³) (⁵)	<u>(7,650)</u>	<u>(9,325)</u>	<u>(14,900)</u>	<u>(18,238)</u>	<u>(7,650)</u>
Units to purchase	78,175	98,825	152,338	172,552	501,890
Cost per unit (⁶)	<u>×\$0.15</u>	<u>×\$0.15</u>	<u>×\$0.15</u>	<u>×\$0.15</u>	<u>×\$0.15</u>
Cost of raw materials purchases *	<u>\$11,726</u>	<u>\$ 14,824</u>	<u>\$ 22,851</u>	<u>\$ 25,883</u>	<u>\$ 75,284</u>

**of Direct
Budget**

Direct material budget is the budget used for determination of raw material that has to be purchased. Material budget is made considering the number of units that are to be produced, the inventory for raw material, and the already present inventory. To calculate the budgeted amount for raw material purchases the number of units that has to be purchased has to be determined and then it has to be multiplied with the cost per unit.

Example of Direct Labour Budget

	<i>Quarter 1</i>	<i>Quarter 2</i>	<i>Quarter 3</i>	<i>Quarter 4</i>	<i>Total</i>
Units to be produced	15,300	18,650	29,800	36,475	100,225
Direct labor hours per unit	<u>x .5</u>	<u>x .5</u>	<u>x .5</u>	<u>x .5</u>	<u>x .5</u>
Total direct labor hours	7,650	9,325	14,900	18,237.5	50,112.5
Cost per hour	<u>x\$14.00</u>	<u>x\$14.00</u>	<u>x\$14.00</u>	<u>x\$14.00</u>	<u>x\$14.00</u>
<u>Cost of direct labor</u>	<u>\$107,100</u>	<u>\$130,550</u>	<u>\$208,600</u>	<u>\$255,325</u>	<u>\$701,575</u>

The direct labour budget is for the determination of the number of labour and the cost of the labour. One pickup truck takes half an hour of labour and the cost per hour is \$14.00. The total direct labour budget decided is for 50,113 hours such that 100,225 trucks can be produced the budget is \$701,575.

Example of Manufacturing Overhead Budget

	1	2	3	4	Total
Variable Costs					
Indirect Materials	\$ 7,650	\$ 9,325	\$14,900	\$18,238	\$ 50,113
Indirect Labor	15,300	18,650	29,800	36,475	100,225
Maintenance	<u>11,475</u>	<u>13,988</u>	<u>22,350</u>	<u>27,356</u>	<u>75,169</u>
Total Variable Costs	<u>34,425</u>	<u>41,963</u>	<u>67,050</u>	<u>82,069</u>	<u>225,507</u>
Fixed Costs					
Supervisory Salaries	3,000	3,000	3,000	5,700	14,700
Property Taxes and Insurance	6,000	6,000	6,000	6,000	24,000
Depreciation	<u>5,250</u>	<u>5,250</u>	<u>5,250</u>	<u>5,250</u>	<u>21,000</u>
Total Fixed Costs	<u>14,250</u>	<u>14,250</u>	<u>14,250</u>	<u>16,950</u>	<u>59,700</u>
Total Manufacturing Overhead	<u>\$48,675</u>	<u>\$56,213</u>	<u>\$81,300</u>	<u>\$99,019</u>	<u>\$285,207</u>
Total Direct Labor Hours *	<u>7,650</u>	<u>9,325</u>	<u>14,900</u>	<u>18,238</u>	<u>50,113</u>
Predetermined Overhead Rate					<u>\$5.70</u>

The manufacturing overhead budget is such which is used for the identification of the fixed and variable overhead costs of the budgeted year. A predetermined overhead rate for the application of overhead to the units produced is used by the pickup trucks company therefore the separation of fixed and variable cost is important.

Example of Selling Expense Budget

The selling expenses budget comprises of the variable and the fixed selling expenses. Variable expenses are those expenses which are based on sales dollars. Following table shows the expenses budget, sales commissions and the delivery expenses.

Variable Expenses					
Sales Commissions	\$ 9,000	\$10,200	\$16,800	\$24,000	\$ 60,000
Delivery Expense	<u>1,500</u>	<u>1,700</u>	<u>2,800</u>	<u>4,000</u>	<u>10,000</u>
Total Variable Expenses	10,500	11,900	19,600	28,000	70,000
Fixed Expenses					
Sales Salaries	<u>12,500</u>	<u>12,500</u>	<u>12,500</u>	<u>12,500</u>	<u>50,000</u>
Total Selling Expenses	\$23,000	\$24,400	\$32,100	\$40,500	\$120,000

4. Standard costs are used for variance analysis and discuss the terms favourable and adverse variances with suitable examples.

4.1 Standard cost

Standard costs are those costs which are calculated taking into account the direct cost of the material, the cost of labour and that of manufacturing of goods. A business often allocates costs to the material, labour, and manufacturing which is different from the actual cost. By doing this allocation, a standard cost that is to be given to each of these things is set. The standard cost of a product is very finely calculated as it has to be used in many different ways. The inventory and sale of goods will be directly reflected in the standard cost. This cost is used as a reference for further calculations (Riewpaiboon, 2014).

4.2. Importance in Decision Making

Standard costs give a scale through which various other departments can be compared, and it can be decided whether the business is in loss or profit. Standard cost can help in making decisions regarding the company as it provides a comparison that indicates loss or profit. The decisions that are based on standard cost analysis profit the company and helps in the growth of the business (Drury, 2008).

4.3 Variance analysis

Standard cost as explained earlier provides a scale with which the actual cost can be compared. Standard cost can either be higher or lower than the actual cost. Due to this difference variance arises, and the management becomes aware that the cost has differed from the expected or planned cost (Garrison, Noreen, and Brewer, 2008).

4.3.1. Unfavourable variance

If the difference between the actual cost and the standard cost is such that the actual cost is higher than the standard cost, the variance is unfavourable. This informs the company or business that the profit generated will be less than what was initially expected.

4.3.2. Favourable variance

If the difference between standard cost and actual cost is such that the standard cost is higher than the actual cost, then the variance is known as favourable variance. In this type of variance, the profit at the end is more than the expected profit of the business (Delane, 1979).

An example can be taken to explain the standard cost and variance. Let's suppose that a company estimates that the cost of raw material for manufacturing of jeans will be 2 dollars but when the material is actually purchased the cost comes out to be 1.5 dollars this means that there is a variance of .5 dollars the estimated cost is was higher than the actual cost and so the profit will be more than the calculated profit. Similarly, if the actual cost would have been 2.5 dollars, then the variance would be negative which would mean that the end profit would be less than the calculated profit (Delane, 1979).

Recommendation

The cost of the toy trucks can be controlled by decreasing the number of labour and making the work such that each person has one specific task to do in the production of the trucks. That way the production time can be decreased and less number of labours will be used.

Conclusion

It is important to control the cost of any product and take wise decisions in a company to make the business successful. All the budgeting and cost controlling is done so that the maximum revenue is generated through minimum expenditure.

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