Management Accounting

Coursework Sample

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Questions

SCENARIO:
The budgeted selling price and standard cost of a unit manufactured by Smillie Limited is as follows:

	£
Selling Price	***30***
Direct Materials (2.5 Kilos)	***5***
Direct Labour (2 Hours)	***12***
Fixed Production Overhead	***8***
Total Cost	***25***
Budgeted Profit	***5***

Total Budgeted Sales: 400 Units

During the period to 31 December 2005, the actual sales and production details for Smilie were as follows:

	£
Sales (420 units)	***13440***
Direct Materials (1260 kilos)	***2268***
Direct Labour (800 hours)	***5200***
Fixed Production Overhead	***3300***
	10768
Profit	***2672***

Requirement

You are employed as a management accountant to supply management with various reports to compare performance against set standards

Task 1

a) ***Calculate the following variances and sub variances from the information given in above:***

    i. ***Direct material - price and usage***
    ii. ***Direct labour - rate, efficiency***
    iii. ***Fixed Costs -Volume, capacity and efficiency***
    iv. ***Sales – Volume and Selling Price***

b) ***Input the variances and sub variances from task 1a into a cost report, clearly showing the sub variances for each section***
c) ***Prepare an operating statement reconciling budgeted and actual results***

Task 2

From the information given calculate the following performance indicators:

a) Efficiency ratio
b) Capacity Ratio
c) Production volume ratio

Task 3

Prepare a report to the managing director of Smillie with your findings of the above data, you must include

- ***Identification of possible causes of the various variances and recommend any corrective action***
- ***Report findings in accordance with identified responsibility centres***
- ***Evaluate the performance indictors and what they show overall in relation to budgeted output***
- ***Explain what is mean by added value and the principles of total quality management to the business and identify potential improvements***
- ***Give recommendations and evaluate the overall performance of the business to budgets set***

The answer must be presented in an informal report with no more than 3000 words, with relevant information only that makes an attempt to understand how to monitor performance against budgets and reduce costs and enhance value within a business.

Answer Report

We have seen an overview for the budgeted selling price and standard cost of a unit manufactured by Smillie Limited.

From the whole view we had found certain variances & sub variances as well as working statements where ever required. There are certain reasons for the amount of variances. As it is the difference between a planned, budgeted or standard cost and the actual cost incurred. Here the same comparisons may be made for revenues. But still it is not important to imagine that the material price variance will always point towards the efficiency of the purchasing department. Due to the change in market prices and conditions actual prices may go over standard prices that cause a general price increase for the materials used. As an alternative, an adverse price variance may reflect a failure by the purchasing department to search for the most valuable sources of supply. A favourable price variance might be due to the purchase of inferior quality materials, which may lead to low-grade product quality or more wastage. For example, the price variance for a particular material is favourable, but we shall see that due to the excess usage of that material it is counterbalance. If the reason for this overkill usage is the purchase of low-grade quality materials then the material usage variance should be charged to the purchasing department. Let us see the different variances taken out as we can see that the material price variance is £ 252 whereas usage variance is around £ 520 .As we see the direct labour rate variance and labour efficiency variance they are totally different as DLRV is £ 400 whereas LEV is £ 0. The fixed overhead expenditure variance is around £ 60. There is also a great difference between Sales price and Sales volume variance because here Sales price variance is around £ 840 and Sales volume variance is around £ 600. It is also possible that for all of part of the price variance another section may be answerable. For example, a lack of materials follow-on from bad register control may demand an emergency purchase being made at short notice. The supplier may hold up added usage and stowage charges on special run orders, and may therefore charges a high price for the materials. In this situation the price variance will be the soundness of the stores department but not the purchasing department. Sometimes if material is used of superior quality than standard or if there is more effective use made of material there will be always then errors in allocating materials to jobs which may give rise to variance. A great reason is always the use of workers at a rate of pay lower than standard. So always the idle time variance is always poor due to this situation. Moreover if the output is produced more quickly than expected then it would differ variance. If there is also a production or level of activity greater than budgeted or increase in unplanned prices or there is any further demand, variance will deviate at a faster rate. There are certain reasons as well or corrective actions which may help us to take control over the deviation in variance. It's more important for extracting the material price variance at the time of receipt. If it is so then they will be brought to the attention of managers earlier than if they are extracted as the material is used. If it is necessary to correct any variances then management action can be timelier. Due to this only all stocks will be valued at standard price. This is directorially easier and it means that all issues from reserve can be made at standard price. If the reserves are held at real cost it is necessary to calculate a separate price difference on each group as it is issued. Since issues are usually made in a number of small batches this can be a time overshadowing commission, especially with a manual system.

Here always a control action is required to improve the precision of the recording system so that measurement errors do not occur. Price standards are likely to become out of date when abundant changes to the costs of substance, power, and work hard and so on occur, or in periods of high increase. In such situation a investigation of variances is likely to highlight a general change in market prices rather than efficiencies or inefficiencies in acquiring resources. Standards may also be out of date where operations are subject to technological development or if learning curve effects have not been taken into account. Investigation of this type of variance will provide information about the inaccuracy of the standard and highlight the need to frequently review and update standards. Spoilage and better quality material/more highly skilled labour than standard are likely to affect the efficiency of operations and hence cause variances. Investigation of variances in this category should highlight the cause of the inefficiency or efficiency and will lead to control action to eliminate the inefficiency being repeated or action to compound the benefits of the efficiency. For example, stricter supervision may be required to reduce wastage levels and the need for overtime working. The purchasing department could be continuing using suppliers of good quality materials. A standard is an average figure and so actual results are likely to deviate suddenly within the expected range. As long as the variance falls within this range, it will be classified as a random or chance fluctuation and control action will not be necessary. Individuals should not be kept in the mysterious situation about their performance. The information fed back about actual results should have the virtues of good information. Reports should always be clear and comprehensive also significant variances should be highlighted for investigation. Reports should be timely, which means they must be produced in good time to allow the individual to take control action before any adverse results get much worse. According to this always a report is in accordance with identified responsibility centres. They always show high performed output. Surprisingly research evidence suggests that all too often accounting performance measures lead to a lack of goal comparison. Managers seek to improve their performance on the basis of the indicator used, even if this is not in the best interests of the organisation as a whole. For example, a production manager may be encouraged to achieve and maintain high production levels and to reduce costs, particularly if his or her bonus is linked to these factors. Such a manager is likely to be highly motivated. But the need to maintain high production levels could lead to high levels of slow-moving stock, resulting in an adverse effect on the company's cash flow. The impact of an accounting system on managerial performance depends ultimately on how the information is used. It always carries three factors such as a budget constrained style of evaluation, a profit conscious style of evaluation and most important is a non-accounting style of evaluation.

We know that different responsibility centres are responsible for each operation. For example, responsibility centre B is responsible for operation 1, responsibility centre A for operation 2, and so on. Here always responsibility centres B, C, D are responsible for the variance. None of the responsibility centres is exclusively answerable for the variance. Responsibility centres be identified with the standard cost for the output achieved it's only the scheme required by the cost control. Only by comparing total actual costs with standard costs for each operation or responsibility centre for a period

can be effectively achieved. The standard costs for the actual output for a particular period are traced to the managers of responsibility centres who are responsible for the various operations. The actual costs for the same period are also charged to the responsibility centres. Standard and actual costs are compared and the variance is reported. The managers of responsibility centres will require a more detailed analysis of the variances to enable them to exercise control, and detailed performance reports should be prepared at monthly or weekly intervals to bring to their attention any significant variances. A departmental performance report should include only those items that the responsibility managers can control or influence. The material price variance and the monetary amount of the variance are not presented, since these are not considered to be within the control of the manager of the responsibility centre.
As we have taken out Efficiency ratio, Capacity ratio and Production volume ratio as follows:

Efficiency ratio: $\frac{\text{Standard hours produced}}{\text{Actual hours worked}} * 100$

Capacity ratio: $\frac{\text{Actual hours worked}}{\text{Budgeted hours}} * 100$

Production volume ratio: $\frac{\text{Standard hours produced}}{\text{Budgeted hours}} * 100$

Here efficiency ratio means the quality of work produced whereas capacity ratio means the potential ability to perform and production volume ration is the mixture of both efficiency ratio and capacity ratio. Therefore to understand the concept of production volume ratio it is necessary to understand the meaning of efficiency & capacity ratio. As from these formulas we have taken out various values of efficiency ratio, capacity ratio and also production volume ratio. So the efficiency ratio is about 105 %, capacity ratio is about 100 % and production volume ratio is around 105 %. From the answers we can see that efficiency ratio is equal to production volume ratio. So with these performance indicators we can get an idea about the budgeted output. Today in this competitive world, quality has become one of the key competitive variables and this has created the need for management accountants to become more involved in the provision of information relating to the quality of products and services and activities that produce them. Eliminating inferior quality can therefore esult in large savings and top revenues. The philosophy of emphasizing production volume over quality resulted in high levels of stocks at each production stage in order to protect against shortages caused by inferior quality at previous stage and excessive expenditure on inspection, rework, scrap and warranty repairs. Here a lot of principles are related to total quality management, but still it's important to know about the meaning of total quality management. It is basically a term used to describe a situation where all business functions are involved in a process of continuous quality improvement. It has been now adopted by the many companies of India and many countries of the world. It has broadened from its early concentration on the statistical monitoring of manufacturing processes to a customer oriented process of continuous improvement. Quality Management gurus are Joseph Juran, W Edwards Deming, and Armand Feigenbum, Kaoru Ishikawa, Genichi Taguchi, and Shigeo,notably Philip Crosby and Tom Peters, who further extended the Quality Management concepts after the Japanese successes. TQ is a people-focused management system that aims at continual increase in customer satisfaction at continually lower real costs. It is a management approach for an organization, centered on quality, based on the participation of all its members and aiming at long-term success through customer satisfaction, and benefits to all members of the organization and to society. TQM has not been independent of its environment. In the context of management accounting systems (MCSs), Sim and Killough (1998) show that incentive pay enhanced the positive effects of TQM on customer and quality performance. Ittner and Larcker (1995) demonstrated that product focused TQM was linked to timely problem solving information and flexible revisions to reward systems. Chendall (2003) summarizes the findings from contingency-based research concerning management control systems and TQM by noting that TQM is associated with broadly based MCSs including timely, flexible, externally focused information; close interactions between advanced technologies and strategy; and non-financial performance measurement. Management accounting systems can help organisations achieve their quality goals by providing a variety of reports and measures that motivate and evaluate managerial efforts to improve quality. These all will include financial and non-financial measures. Many companies are at present are unaware about spending money on quality because they are incurred across many different departments and not accumulated as a separate cost object within the costing system. Always a cost of quality of report should be prepared to indicate the total cost to the organization of producing products or services that do not confirm with quality requirements. Costs of the compliance are incurred with the intention of eliminating the costs of failure. The optimal investment in compliance costs is when total costs of quality reach a minimum. Let us know about the various variances & sub variances values form the data solved below. As we can see that 1260 units should have cost £ 2520 but did cost £ 2268. The overall material price variance is £ 252. Whereas usage variance is £ 520. On other hand the direct labour rate variance is around £ 520. Here the 800 hours should have cost £ 4800 but did cost £ 5200. The labour efficiency variance is £ 0 because standard hours for budgeted is 800 whereas actual hours hours used is 800 so the difference is 0. Now the budgeted fixed overhead expenditure is £ 3360 and actual fixed overhead expenditure is £ 3300, due to which the fixed overhead expenditure variance is £ 60. So at last we had got the actual profit of around £ 2672. In the field of performance indicators the efficiency ratio is around 105%, capacity ratio is 100% and production volume ratio is 105%.

At last we can discuss now about the various recommendations which may be suitable for better output. Always efficient and best method have to be used for production of goods. Weekly investigations should be done for proper output which highlight the cause of the inefficiency or efficiency and will lead to control action to finish off the inefficiency being repeated. Next is the serious or strict supervision of goods for checking wastage of products. Here the purchasing department should be encouraged to continue using suppliers of better quality. Properly on daily basis the errors should be recorded and checked to increase the output. A control action is always required to improve the accuracy of the recording system. Always here the needs has to be highlighted for frequent reviews and updated standards. Last but not least there should be a better standard costing system which provides a prediction of future costs on which decisions are made whereas it also provides a challenging target with a reliable and convinient source of data for budget preparation. Overall we can say that the task is simplified a lot.

References :

Management and cost accounting by Colin Drury.

Financial management and control by Bpp Professional Education.