Essay on managerial accounting

Business, Company

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Challenges of NPV and IRR

There are several challenges in using the NPV and IRR methods in capital budgeting such that experts have now recommended the use of MIRR. The IRR method assumes that the company will get positive cash flows during the life of the project. This at times may not be true especially for projects which have negative cash flows. The alternating cash flows will generate multiple answers. Secondly, the method assumes that any re-investment of cash that occurs will be at the IRR which is not realistic. The method does not tally with the results of NPV results when it comes to the accept/reject decisions. The two methods will also not rank the projects in a similar manner.

The NPV method also has challenges. First of all the amounts of cash flow are estimated and uncertainty of the cash flows is not considered in the calculation. Secondly, the re-investment of the cash flows is expected to be at the cost of capital yet the rate of return may change. The NPV method gives inconsistent results for those projects have different economic lives (Volkman, 1997). The method has a challenge in aiding the manager in selecting superior investments. Taking an example of a manufacturing

company that invests in different projects which have different economic lives and alternating cash flows, the IRR and NPV methods will not be suitable for the manager to use.

Management Accounting

The main concepts of management accounting addressed by Wild are on cost analysis. He states that management accounting provides financial and non-financial information to the management to aid in decision making (ACCA, 2010). He highlights several differences between management and financial accounting. Financial accounting is provided to the external stakeholders of the company to monitor the company's financial performance. The main managerial costs concepts in managerial accounting are traceability, behaviour, controllability, relevance and function (Wild & Shaw, 2010).

Cost behaviour assists the managers to investigate the effect of increasing or decreasing the production of a particular good or service. It shows how the costs react in changes in business production levels. Fixed costs do not change with change with business levels however variable costs are affected by changes in business production levels. There are certain costs that can be traced to the product while there are other costs that not traceable. Direct costs such as direct materials and labour are traceable however overheads such as maintenance costs have to be apportioned or allocated to the products using a suitable base.

The aspect of cost controllability depends on the level of management in the particular department. At the top, costs are more controllable since it is the

management which control the costs. At the lower levels costs are less controllable. The management should be aware of the relevant costs when analysing whether to take up a project or not. The sunk costs are costs that have already been incurred and the management should not consider such costs in decision making. The management should consider the out-of-pocket expenses that have not yet been incurred. The management should also consider the opportunity costs in decision making. What is the cost of what has been forfeited in comparison with the gain on the course of action chosen?

Costs can also be based on the product or the period. From the information discussed, it is clear that management accounting assists the company in correct costing of the product. It reduces over-costing and under-costing of products.

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