Sample case study on babcocks solutions ltd company

Business, Company

Marginal cost and absorption cost are two methods that are significant in the modern day manufacturing companies. Absorption costing method is necessary when financial statements of a given company are prepared for external purposes. One of the important principles in the absorption cost is that unit produced and inventory must involve a share of all production costs, both variable and fixed, incurred in acquiring them to the current situation. On the other hand, marginal costing method is applicable when making internal decisions. Since fixed costs are incurred in all levels of financial activities, the main purpose of this method is computing the contribution that is being generated, that is sales minus variable costs (Hansen, & Mowen, 2000).

The difference experienced between the figures generated by the absorption costing technique and marginal costing is as a result of the treatment of fixed production operating expense. In the marginal costing the entire components of fixed production overhead/operating expenses is written of in the period that is experienced. Contrary, in the absorption costing, the fixed production operating expenses is carried forward in the accounting period as share of the inventory valuations.

Merits and limitations of the Net Present Value

NPV is an essential method of project appraisal since it provides a time value of money. This method enables measuring of the shortfall or excess of cash flows. The cash flows in this model are discounted at a specific rate during the course of the project which is significant in the absence of capital rationing (Hansen, & Mowen, 2000). However, some of the limitations of the NPV approach are that they involve difficult computations and this might lead to inaccuracy. The method may also lead to misleading decisions because the project may incur a negative cash flow which is different from the projected positive one.

Merits and limitations of the Internal Rate of Return

This method involves the calculation of the break-even whereby, the alternative cost of capital involving the suitable risk premium is computed. However, this approach cannot be used to rate projects that are mutually exclusive. This method does not involve the usual manner of the project that begins with positive cash inflow, like intermediate cash flows are not involved in the IRR projections. “ The multiple IRR problem” is another limitation concerning IRR approach. This problem is experienced when there are negative cash flows in the course of the project. In other words, the project may either be operating at a loss or the company may require top contribute more. Therefore, IRR is considered to be little oversensitive compared to NPV.

In the modern project management, the theory of constraints is applied to determine what to change through the application of the cause-and-effect modeling. It is an effective tool since it has a capacity to analyze the system specifically and determine the effectiveness of the project. This method has a significant principle that is different from other methods. For instance, the quantitative method of analysis is being limited to calculate what could be contrary to the theory of the constraint that provides room for speculative (Hansen, & Mowen, 2000). This theory also identifies ineffectiveness and inefficiencies; assuming their causes and formulate strategy as a result. One of the dominant advantages of using theory of constraint is to implement changes in the organization or the company. However, managers should bear in mind that resistance to change is common and can lead to failure of the system.

References

Hansen, D. R., & Mowen, M. M. (2000). Management accounting. Cincinnati: South-Western College Pub.