

Managerial accounting essay sample

[Profession](#), [Manager](#)



1-Introduction

A good understanding of the relationship between cost and activities in a company is necessary for managers in every type of organization and this clothing manufacturing company is concerned because they do not have this understanding and what benefits it has for guiding managers to understand the changes and effects different future business decisions and alteration of those decisions have on the expenses and profit but. Although there are benefits to finding and fully understanding these relations there might be problems on the way which will be discussed further on. After reaching an understanding about the relationship between costs and business activities and analyzing cost behaviors, we could then use those information for predicting future profit changes due to changes in volume of activity, costs and prices of products. What effects can this manufacturing company expect on their profit if they add a new production line or they alter the machines and variable expenses change? All these questions are addresses using managerial accounting technique called cost volume profit.

2-1 Cost Behavior, benefits and difficulties ahead

Change in organizations activity like designing or producing new type of clothing can affect costs of this manufacturing company. The relationship between costs and activity is called cost behavior or cost function. Providing knowledge of cost behavior helps the managers to make more accurate cost predictions. Which ultimately serves as a tool for managers in this organization for planning, controlling and decision making. Which needs the prediction of costs, prices and how they are effected by changing activity volumes. (Hilton and Platt 2014) But different costs demonstrate different

cost behavior patterns. We cannot apply cost drivers from different manufacturing companies to one other.

There are different cost estimation methods for forecasting relations between cost and activity as mentioned by like manufacturing cost estimation methods like Activity based costing to “ manufacturing cost estimation of standard mechanical components to cost analysis of highly customized assembled products and process cost optimization techniques to specific methods for overhead costing.” (Niazi, et al. 2005). Often managers apply more than one of them and combine them to get better results, but no matter which method is used, the result relies on the data that was collected, and there are usually six different problems that interfere while collecting data. Misplacing or not recording part of the data, or data from highly unusual situations which could deviate the calculations and using different time units for different activities are three of these problems (Hilton and Platt 2014).

When it comes to data collection process trade-offs in choosing the time period is another factor that could complicate matters. Also not being able to determine how the amount of allocated and discretionary costs are assigned is another problem, for instance facility costs and property taxes which are allocated to units of production and they might seem varying depending on the size of production whereas discretionary costs seems as they are variable costs due to changes in managerial decisions. After considering all these factors there is always inflation which plays an important role on

historical cost data, and fluctuations in inflation rate may have insufficient relativity for future cost and activity behaviors.

Cost behavior analysis plays an important role in predicting the profit of the organization. Prediction of the effects on profit when volume, cost and price varies due to for instance activity changes, is manager's essential need to plan ahead and make decisions. This could be done by using managerial accounting technique, Cost-volume-profit analysis or CVP analysis.

2-2 Using CVP as a mean for Prediction

As it is discussed by (Hilton and Platt 2014) in CVP, sales revenue is calculated then variable expenses is subtracted from that amount, the remaining value is the total contribution margin. This amount is available to cover the fixed expenses, any remaining after this deduction is called profit. There is a particular point in this equation, and that is when there is no remainder and both values are equal, this point is called the break-even point, which means there is no loss or profit for the organization. Dividing fixed expenses by this break-point will result in unit contribution margin. In clothing company because number of different products are been produced, weighted average unit contribution margin is needed, that is average of unit contribution margin of different products, weighted by proportional sales of each product.

In case of fixed expenses changing and other factors been remain the same, due to management decisions for example, adding a certain production line or just making different estimates of future fixed expenses, cause the break point to alter. The same is applied for any other changes including changes

in unit variable expenses and changes in sales prices because of new competitor on the market all affect the break-even point and ultimately changing the profit margin. By interpreting these values into profit equations and plotting them on a graph we will be able to show the relationship between profit and volume of activity. CVP analysis is only acceptable only if certain assumptions within the relevant range is met.

There are difficulties arising from these assumptions, one assumption is that sales mix remain constant within the range of analysis in manufacturing companies where more than one kind of product is produced and depending on management decisions and demand of different amount of demand over a period that raises concern (Jaedicke and Robichek 1964). Also another assumption is that prices stay the same as sales volume changes whereas in cases revenue is curvilinear not linear, same applies to total expenses which in most cases they are not, and their variables causing uncertainties which makes it hard for using this tool for decision making. These uncertainties and not being able to include the real world risks into this model by these assumptions makes it limited and in certain situations not so useful for example it does not consider the changes in volume of production and the effect it does on demand of the product and production factor efficiency.

3- Conclusion

In conclusion, the benefit of knowing cost behavior and being able to analyze it helps managers predict costs, and ultimately make better future decisions, also having knowledge about cost functions is the first step of cost-volume profit analysis, but have to consider this that they are as reliable as accurate

as the data that was collected for these studies were reliable. Using CPV management is able to predict the profit changes yet to happen and again make for effective choices. There are downside to CPV and that is in limits certain possibilities because of the assumptions that must be met using this method.

4- Reference

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