

# Management and financial accounting

Finance



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 experienced a sharp down trend in the recent times. As such, people are on  
 the job of improving their own homes rather than buying or selling of houses.  
 Lofty Heights which is a firm into improving of homes, as such, is expanding  
 vastly taking the advantage of this downturn. Its headquarters are in South  
 Wales but, it is growing nationally with Jeff (owner) as the sales and  
 marketing personnel and Evans (employee) as the financial manager. The  
 company is expanding further to form newer departments in the  
 organizational structure like HR, Customer Service etc. It follows absorption  
 costing for ascertaining its unit costs and is a sole proprietorship business  
 entity as on date. Task – F2 – Management Accounting: Solution – a: Amount  
 of profit budgeted to be made for each of the loft conversions: Particulars 23  
 31 36 Sales 28, 500 39, 500 55, 500 Less: Direct Costs 7, 800 14, 500 18,  
 500 Gross Profit 20, 700 25, 000 37, 000 Less: Allocated Fixed O/h's 12, 000  
 12, 000 12, 000 Net Profit budgeted 8, 700 13, 000 25, 000 Solution – b:  
 Allocated fixed o/h's HR Finance CS Building Planning 2, 000 3, 000 3, 000  
 20, 000 8, 000 Table – 1. Apportionment basis Total HR Finance CS Building  
 Planning Floor area (sq. m)(? 16. 84/m) 16, 000 1011 1516 2526 3368 7579  
 Kilowatt Hours (? 12. 9/ hr) 12000 516 1032 1419 6452 2581 Machine Value  
 (? 0. 09/hr) 12000 109 228 319 10934 410 Allocated total 40000 1636 2776  
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4265 20754 10570 Table – 2. Department Primary distribution method

HR 3, 636 -3636 Finance 5, 776 185 -5, 961 CS 7, 265 370 596 -8, 230

Building 40, 754 2465 3577 5604 52, 400 Planning 18, 570 616 1788 2626

23, 600 Total 76, 000 76, 000 Table – 3. Conversion no. Building Planning

Total 23 6835 5710 12545 31 19935 7867 27800 36 25630 10024 35655

76000 Solution – c Table – 4. Particulars 23 31 36 Sales 28, 500 39, 500 55,

500 Less: Direct costs 7, 800 14, 500 18, 500 Gross Profit 20, 700 25, 000

37, 000 Less: O/H's 12544 27801 35654 Profit 8, 156 -2, 801 1, 346 Working

Notes: Solution - a: The allocated overheads to the various departments =

$20000+8000+3000+2000+3000 = 36000$ . They are equally distributed to

each loft conversion as  $36000/3 = 12000$ . Solution - b: Table - 1 -

Apportionment of unallocated fixed overheads. Rent and rates: It is done on

the basis of floor area/sq. mt. The formula is: Rent and rates /Total floor area

$= 16000/950 = 16.84/m$ . This 16.84 is multiplied to the respective floor

area figures given. Power, heat and light: Basis - Kilowatt hours. Power, heat

and light /KWH  $= 12000/930 = 12.9/hr$ . This 12.9 is multiplied to the

respective KWH figures given. Insurance costs - Basis - Machine Value.

Insurance costs payable/Machine value  $= 12000/131700 = .09 / hr$ . This .09

is multiplied to the respective machine value figures given. Table - 2. Re-

apportionment of overheads to production departments. HR overheads =

allocated o/h's + apportioned o/h's  $= 2000+1636 = 3636$ . They are

distributed to the other departments on the basis of no. of employees. The

ratio is thus 6: 12: 80: 20. Re-apportionment of HR o/h's for Finance =

$(3636/118)*6 = 185$ ; CS  $= (3636/118)*12 = 370$  Building  $= (3636/118) * 80$

$= 2465$ ; Planning  $= (3636/118)*20 = 616$ . Finance overheads

$(3000+2776+185 = 5961)$  are distributed to Building, planning and CS

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departments in the ratio of 6: 3: 1 (given). Re-apportionment for CS =  $(5961/10)*1 = 596$ ; Building =  $(5961/10)*6 = 3577$ ; Planning =  $(5961/10) *3 = 1788$ . CS overheads of  $(3000+4265+370+596) = 8230$  are distributed to building and planning on the basis of CS tasks in the respective departments. The ratio is 1600: 750. Re-apportionment for Building =  $(8230/2350)*1600 = 5604$ ; Planning =  $(8230/2350)*750 = 2626$ . Thus Overheads are apportioned to: Building =  $40754+2465+3577+5604 = 52400$ . Planning =  $18570+616+1788+2626 = 23600$ . Table - 3: Allocation of overheads to loft conversions: Planning - Conv. 23 =  $(23600/186) *45 = 5710$ . Conv. 31 =  $(23600/186)*62 = 7867$ . Conv. 36 =  $(23600/186) *79 = 10024$ . Building - Conv. 23 =  $(52400/9200) *1200 = 6835$ . Conv. 31 =  $(52400/9200) *3500 = 19935$ . Conv. 36 =  $(52400/9200) * 4500 = 25630$ . The total overheads for loft no. s in table - 4: Conv. No. 23 = Building+planning o/h's =  $5710+6835 = 12545$ . 31 =  $7865+19935 = 27800$ . 36 =  $10025+25630 = 35655$ . Solution - d Relevance of absorption costing: The fixed overheads are being allocated to the three loft conversion units according to their labor hour utility. But, this type of costing is more suitable only when: There is only one conversion Production is calculated on the basis of normal capacity and There is no inventory. In this case, there are three conversions. Allocation of Variable and fixed overheads to production is giving disrupted profit figures which may lead to faulty managerial decisions. For example, conversion no. 31 may show a loss but if closed will lead to allocation of fixed o/h's to other conversions and they will show a loss. Instead only variable costs should be deducted from sales to find out the contribution. This is called marginal costing. The key elements of marginal costing are: Cost classification of variable and fixed overheads. Production is only charged with variable costs

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Selling price can be fixed after adding up variable costs and the required contribution. Break-even analysis decides whether to continue a particular conversion or not. Thus, it is better to shift to marginal costing system to ascertain the right profitability. (Jain. S. P. & Narang. K. L. – 2006). F3 - Financial Accounting: Solution - a: In Lofty heights, Jeff is the owner and Evans is an employee of the business right from the time of inception. The possible two forms of business could be sole proprietorship or partnership. Currently, they are following the sole proprietorship business. But, with the expansion, decision needs to be taken in light of the following occurrences:

Nature and size of the firm Control levels Implications of tax Profit or loss expected of the business. Sole proprietorship can be suitable for smaller organizations. Its advantage lies in starting, decision making, profits and dissolution. But, Unlimited liability; difficulties of raising funds, tax deductions, caliber retention, business transfer are disadvantages. Taking up Evans as a partner and forming a partnership firm can be considered as the business is fast expanding. By such a move, advantages of easy establishment, raising funds, profit sharing and skill benefits can be enjoyed. The disadvantages of partnership include unlimited liability jointly and even severally, profit sharing, disagreements, tax deduction unavailability and death of partners leading to dissolution. Two kinds of partnerships are emerging: limited and unlimited partnership. In the limited partnership, liability is limited for those who do not take active participation in the management. But, such a case is not possible in Lofty. It is also not possible to continue as sole proprietor with a view to the expansion of business. Hence, partnership with unlimited liability is the most suitable business form. (Anon., 2011). Solution - b - 1: Insurance a/c Dr. Cr. Particulars Amount

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Particulars Amount To Bank a/c 24, 000 By Insurance prepaid a/c 20, 000  
 By Profit & Loss a/c 4, 000 Total 24, 000 Total 24, 000 Insurance prepaid a/c  
 Dr. Cr. Particulars Amount Particulars Amount To Insurance a/c 20, 000 By  
 Balance c/d 20, 000 Total 20, 000 Total 20, 000 Working notes for  
 insurance (in ?): Insurance paid on 1st Sept. 2010 till 1st Sept. 2011 24000  
 Insurance cost for two months of Sept. & Oct. 2010 4000 Prepaid insurance  
 from 1st Nov. to 1st Sept. 2011 20000 Solution – b – 2: Debtors a/c Dr. Cr.  
 Particulars Amount Particulars Amount To Bank a/c 435, 250 By Bad debts  
 a/c 5, 250 By Bank a/c 430, 000 Total 435, 250 Total 435, 250 Dr.  
 Bad Debts a/c Cr. Particulars Amount Particulars Amount To debtors a/c 5,  
 250 By provision for b. d'sa/c 5, 250 Total 5, 250 Total 5, 250 Prov.  
 For D. D. s a/c Dr. Cr. Particulars Amount Particulars Amount Bad debts a/c 5,  
 250 By balance b/d 8, 700 To Balance c/d 12, 900 By Profit & Loss a/c 9, 450  
 Total 18, 150 Total 18, 150 Working notes for bad and doubtful debts (in ?):  
 Debtors as on 31st Oct. 2010 435250 Provision as on 31st Oct. 2010 8700  
 Less: Bad debts 5250 Difference 3450 Provision to be maintained: 12900  
 Less: difference- Prov& bad debts 3450 Provision to be created: 9450  
 Solution – b - 3: Van a/c Dr. Cr. Particulars Amount Particulars Amount To  
 Bank a/c 15, 000 By Depreciation 3, 000 By Balance c/f 12, 000 Total  
 15000 Total 15, 000 To Balance b/d 12000 By Depreciation 2, 400 By  
 Balance c/f 9, 600 Total 12000 Total 12, 000 To Balance b/d 9600 By  
 Depreciation 1, 920 By Balance c/f 7, 680 To Balance b/d 7680 By Bank 5,  
 000 By Depreciation 768 By Profit & Loss a/c 1, 912 Total 7, 680 Total  
 7680 Dr. Depreciation a/c Cr. Particulars Amount Particulars Amount To van  
 a/c 3, 000 By Profit & Loss a/c 3, 000 Total 3, 000 Total 3, 000 To van  
 a/c 2400 By Profit & Loss a/c 2, 400 Total 2400 Total 2, 400 To van a/c

1920 By Profit & Loss a/c 1, 920 Total 1920 Total 1, 920 To van a/c 768  
 By Profit & Loss a/c 768 Total 768 Total 768 Purchase value of the van 1st  
 May, 2007: 15000 20% Depreciation 3000 Written down value on 1st May,  
 2008 12000 20% Depreciation 2400 WDV on 1st May, 2009 9600 20%  
 Depreciation 1920 WDV on 1st May, 2010 7680 20% Depreciation for 6  
 months from May to Oct. 2010 768 WDV as on 1st Oct., 2010 6912 Insurance  
 reporting is done in consonance with matching concept and IFRS 4. Bad  
 debts are reported because the customer is absconding. The other 3%  
 debtors are transferred to the provision in consonance to the matching  
 concept and IAS 37. Depreciation is accounted in consonance to cost concept  
 and IAS 8. Extract of Income Statement & B/S as on 31st Oct. 2010 Dr. Cr.  
 Particulars Amount Particulars Amount To Insurance a/c 4000 To Provision for  
 D. D. 9450 To loss on sale of van 1912 To Depreciation 768 Liabilities  
 Amount Assets Amount Debtors a/c 435250 Less Prov. For D. D. s 9450 Net  
 debtors 425800 Prepaid Insurance 20000 (Shukla. M. C., Grewal. T. S.,  
 Gupta. S. C. – 2008) Conclusion: It has been observed that Lofty heights are  
 using absorption costing, wherein variable and fixed overheads are assigned  
 to production for its profit ascertainment. But, by calculating profit on the  
 basis of marginal costing can help the firm to take prudent managerial  
 decisions. The firm is in the expansion stage with more departments created  
 in its organizational structure. The business is also expanding on a national  
 scale with its operations spreading to other places. Hence, maintaining sole  
 proprietorship will lead to limitations of liability and manpower. So, it is  
 better to convert the organization into a partnership firm. As Jeff and Evans  
 are active in the organizational management, would have to take up  
 unlimited partnership. References: Jain. S. P. & Narang. K. L. (2006) Cost  
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