

# CHAPTER 05

## Pricing

Following figure sets out how the total cost of a product (ie. cost unit) is built up and how the selling price of the same product is arrived at.

	Rs.
Direct Material	X
Direct Labour	X
Other direct expenses	X
∴ Prime Cost	X
(+) Fixed production O/H Costing	X
∴ Production / Factory Cost	X
(+) Selling & distribution O/H	X
(+) Administrative O/H	X
∴ Total Cost	X
(+) Profit (Note) Pricing	X
∴ Selling Price	X

**Note:** Profit may be either a mark-up or a margin.

As shown in the above figure, the process of ascertaining the cost of a product is known as "Costing", while "Pricing" is the technique to fix/set a price for the product.

### 1.1 Mark-up and Margin

When the profit of a product is calculated as a percentage (%) of it's cost, (cost of sales) it is referred to as a "Mark-up".

Eg:

ABC PLC is a manufacturing company and its pricing policy is to add a 25% of the product's cost. Total cost of product "P" is Rs. 80/-. Calculate the selling price of product 'P'.

	Rs.
Total Cost	80
(+) Mark-up (25%)	$20 \leftarrow \left[ 80 \times \frac{25}{100} \right]$
	100

In contrast, if the profit of a product is calculated as a percentage (%) of selling price, it is called a "Margin".

Eg:

In above ABC PLC, if the pricing policy was to add a margin of 20%.

	Rs.
Cost	80
(+) Margin (20%)	$20 \leftarrow \left[ 80 \times \frac{20}{100} \right]$
	100

If the profit is expressed as a percentage of the cost of the product (ie. mark-up), you can assume the cost is as 100. If the profit is 25% of the cost, the selling price could be assumed as 125. Then the profit, as a percentage of selling price, would be 20%.

$$\left[ \frac{25}{125} \times 100 \right]$$

**Exercise (1) - MCQ**

A shirt which costs to the retailer Rs. 1,500 is sold at a profit margin of 25% on the selling price.

You are required to calculate the profit and the selling price.

- (A) 500 ; 2050
- (B) 375 ; 1875
- (C) 500 ; 2000
- (D) 300 ; 1800

**Calculations:**

Since the profit is a percentage of selling price, selling price should be assumed as 100. So, the cost would be assumed as 75.

Rs.

Cost	→	1500	
∴ Profit Margin		500	$\left[1500 \times \frac{25}{75}\right]$
		<hr/>	
∴ Selling price		2000	
		<hr/>	
∴ Answer is (C)			



# CHAPTER 06

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## Integrated Accounting

There are no statutory requirements for a manufacturing entity to maintain cost records. However, almost all manufacturing companies maintain cost accounts using a proper double entry system. The system used to record costs varies from organization to organization. Each organization maintains its system to suit its own needs of information. It can range from a simple manual system to an advanced computerized system. The system used by a manufacturing entity to facilitate for cost analysis and recording is called "cost book keeping system".

### 1.1 Methods of keeping cost records

There are two alternative methods to keep cost records of a manufacturing concern.

- (1) Non-integrated Accounting System
- (2) Integrated Accounting System

#### 1.1.1 Non-integrated System

This system is also known as "non-integral" or "Interlocking" system.

In a non-integrated system, two separate sets of books are maintained for cost and financial transactions. (Whereas an integrated system keeps only one set of books for both cost and financial transactions). However both these systems follow the principle of double entry system.

In a large business concern, financial ledger is handled by the Financial Accountant while the cost ledger is handled by the Cost Accountant.

However, Modern business organisations do not maintain separate ledgers for financial transactions and cost transactions. (ie. not use a non-integrated system).

#### 1.1.2 Integrated System

As mentioned above, the integrated system is the system where all financial and cost transactions are recorded in one set of books. ie. it maintains one ledger. So, it is a composite system of cost book keeping, which serves for both purposes, cost accounting and financial accounting. This is the most preferred system for computerization.

### 1.2 Accounting entries of an Integrated Accounting System

The typical journal entries those are used to record transactions in an integrated accounting system are given below.

Transaction	Double Entry	
1. Purchase of material on credit	Materials/Stores Control A/C	Dr.
	Creditors Control A/C	Cr.
2. Purchase of material by cash	Materials/Stores Control A/C	Dr.
	Cash / Bank	Cr.
3. Material purchased for a special job on credit	WIP Control A/C	Dr.
	Creditors Control A/C	Cr.
	(Relevant Job A/C) (Memorandum purpose)	Dr.
4. Material issued - Direct	WIP Control A/C	Dr.
	Materials/Stores Control A/C	Cr.
5. Material issued - Indirect	Overhead Control A/C	Dr.
	Materials/Stores Control A/C	Cr.
6. Material returned to supplier	Creditors Control A/C	Dr.
	Materials/Stores Control A/C	Cr.
7. Return of direct material to stores	Materials/Stores Control A/C	Dr.
	WIP Control A/C	Cr.
8. Return of indirect material to stores	Materials/Stores Control A/C	Dr.
	Overhead Control A/C	Cr.
9. Material transferred from one job to another	Job A/C (to) Job A/C (From)	Dr.
		Cr.
10. Wages	Wages Control A/C	Dr.
	Cash / Wages payable A/C	Cr.

11. wages allocated (Direct)	WIP control A/C  Wages Control A/C	Dr.  Cr.
12. wages allocated (Indirect)	Overhead Control A/C  Wages Control	Dr.  Cr.
13. Direct expenses	WIP Control A/C  Expenditure Creditors Control A/C	Dr.  Cr.
14. Actual overheads incurred (Production O/H)	Overhead Control A/C  Cash / Ex. Creditors Control A/C	Dr.  Cr.
15. Overheads absorbed (Production O/H)	WIP Control A/C  Overhead Control A/C	Dr.  Cr.
16. Non-production overheads incurred (Administration, selling and distribution O/H)	Non-production O/H Control  Cash / Ex. Creditors Control A/C	Cr.  Cr.
17. Non-production overheads absorbed (if absorbed only)	Cost of sales A/C  Non-production O/H Control A/C	Dr.  Cr.
18. Depreciation on machinery used for production	Production O/H Control A/C Provision for Depreciation A/C	Dr.  Cr.
19. Finished goods produced (at cost)	Finished Goods Stock Control A/C  WIP Control A/C	Dr.  Cr.
20. Finished goods sold (at factory cost)	Cost of Sales A/C  Finished Goods Stock Control A/C	Dr.  Cr.
21. Sales	Debtors' Control A/C  Sales A/C	Dr.  Cr.
22. Sales returns	Sales A/C  Debtors' Control A/C	Dr.  Cr.

23. Under absorption of O/H	Profit and Loss A/C	Dr.
	Overhead Control A/C	Cr.
24. Over absorption of O/H	Overhead Control A/C	Dr.
	Profit and Loss A/C	Cr.
25. Interest paid	Interest Expense A/C	Dr.
	Cash / Bank	Cr.
26. Rent on own premises (Notional rent)	Overheads Control A/C	Dr.
	Notional Rent A/C	Cr.
27. Abnormal idle time	Profit and Loss A/C	Dr.
	Wages Control A/C	Cr.

**E<sub>g</sub>: Example**

Penguin manufacturing PLC operates an integrated accounting system and following balances were shown in the opening trial balance prepared as at 1<sup>st</sup> January 2020.

	<u>Rs.</u>	<u>Rs.</u>
Buildings	600,000	
Plant and machinery (at cost)	1,098,750	
Cash at banks	104,670	
Cash in hand	70,013	
Debtors control A/c	373,920	
Raw material stock	309,000	
WIP stock	181,950	
Finished goods stock	229,822	
Issued and fully paid share capital		1,875,000
Provision for depreciation		285,000

Reserves (B/forward P&L)	487,500
Creditors control A/c	320,625
	2,968,125
	2,968,125

Transactions for the six months' period ended 30<sup>th</sup> June 2020 were as follows.

Purchases of raw material on credit	919,500
Material issued to production	627,158
Material issued to factory maintenance	48,817
Direct wages on production (Note 1)	186,825
Indirect wages on production	46,898
Production salaries	22,387
Administration salaries	82,935
Selling and distribution salaries	46,642
Production overheads incurred	32,145
Administration overheads incurred	52,628
Selling and distribution overheads incurred	37,012
Cash paid to trade creditors	1,067,705
Cash paid to expenditure creditors	97,015
Salaries and wages paid	307,688
Cash received from debtors	1,391,047
Discounts allowed	15,750
Discounts received	29,445
Absorbed overheads - Production	215,625
Absorbed overheads - Administration	138,750
Absorbed overheads - Selling and distribution	81,000
Depreciation - on plant and machinery	71,400
Sales	1,656,000
Bad debts - Provision	30,750
Production cost of finished items	1,162,500
Production cost of goods sold	1,297,500



Note 1: This includes accrued wages of Rs. 51,000

You are required to:

1. Write up all the necessary accounts

**Exercise (1)**

M and S is a manufacturing company, which produces baby wears to the European market. It operates an integrated accounting system for cost book keeping. Using the information given below for the month of October 2019, you are required to prepare the following accounts.

- (i) Raw material control account
- (ii) WIP control account
- (iii) Finished goods control account
- (iv) Production overhead control account
- (v) Wages and salaries control account
- (vi) Selling and administration overhead control account
- (vii) Cost of sales account
- (viii) Trading, profit and loss account

**Balances as at 1<sup>st</sup> October 2019**

	Rs. '000
Raw material control	20,000
Work-in-progress control	30,000
Finished goods control	36,000

**Transactions for the month of October 2019**

	Rs. '000
Material purchase on credit	100,000
Material issued to production	84,000
Material issued to production - Services	10,000
Direct wages incurred	60,000

Indirect wages incurred on production	26,000
Selling and administration salaries incurred	24,000
Other production expenses incurred	16,000
Selling and administration expenses incurred	18,000
Provision for depreciation - Production equipment	6,000
- Sales and admin. Equipment	4,000

Wages and salaries paid:

Direct wages	56,000
Indirect wages - Production	26,000
Selling and admin. - Salaries	24,000
Cost of production transferred to finished goods	180,000
Production cost of goods sold	194,000
Sales on credit	290,000

Production overheads are absorbed to the production at the rate of 80% of direct wages incurred.

**Answer**

**Raw materials control A/C**

Balance B/F	20,000	WIP control	84,000
Creditors control	100,000	Production O/H control	10,000
		Balance C/D	26,000
	120,000		120,000
Balance B/F	26,000		

**Work-in progress control A/C**

Balance B/F	30,000	F/goods control	180,000
R/mat. control	84,000		
Wages control	60,000		
Production O/H control	48,000	Balanced C/D	42,000
	222,000		<u>222,000</u>
Balance B/F	42,000		

**Finished goods control A/C**

Balance B/F	36,000	Cost of sales	194,000
WIP control	180,000	Balance C/D	22,000
	216,000		<u>216,000</u>
Balance B/F	22,000		

**Production overheads control A/C**

R/mat. control	10,000	WIP - absorption (Note 1)	48,000
Wages control	26,000		
Cash - other expenses	16,000	Under absorption (transferred to P&L)	10,000
Provision for depn.	6,000		
	58,000		<u>58,000</u>

**Wages and salaries control A/C**

Bank-paid salaries/wages	106,000	WIP control	60,000
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Balance C/D (payable)	4,000	Production O/H control	26,000
			24,000
	110,000	Sell. and admin O/H control	110,000
		Balance B/F (payable)	4,000

**Selling and admin. Overheads control A/C**

Salary control	24,000	P & L	46,000
Cash-other expenses	18,000		
Provision for depn	4,000		
	46,000		46,000

**Cost of sales A/C**

F/goods control	194,000	P & L	194,000
	194,000		194,000

**Trading, Profit and loss A/C**

Cost of sales	194,000	Sales - debtors	290,000
Gross profit C/D	96,000		
	290,000		290,000
Under absorption of prodn. O/H	10,000	Gross profit B/F	96,000
Selling and admin. O/H	46,000		
Net profit for October	40,000		
	96,000		96,000

**Note: (1)**

Absorbed production overheads (60,000 x 80%) = 48,000

