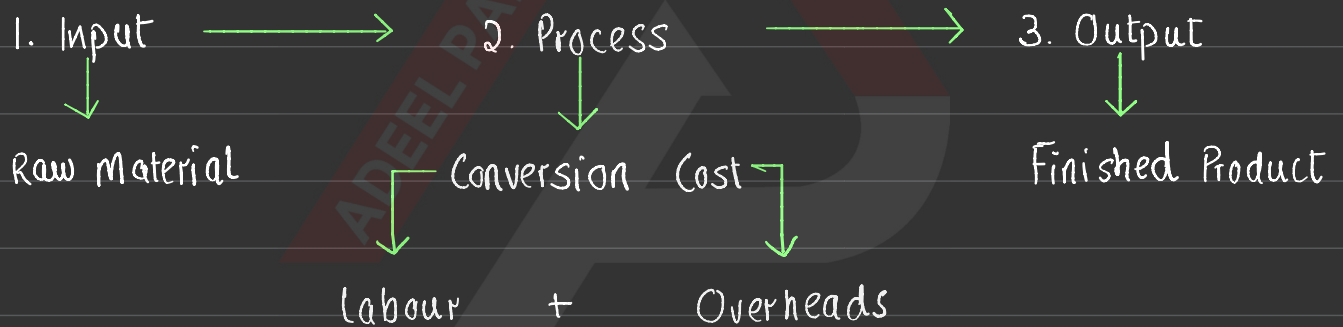


# MANUFACTURING ACCOUNTS

Business Activities		
Trading	Manufacturing	Service
<ul style="list-style-type: none"><li>Businesses involved in buying and selling of goods</li><li>Hold inventories in form of:<ul style="list-style-type: none"><li>i. Finished Goods</li></ul></li></ul>	<ul style="list-style-type: none"><li>Businesses involved in production or value addition of goods.</li><li>Hold inventories in form of:<ul style="list-style-type: none"><li>i. Raw material</li><li>ii. Work in Progress</li><li>iii. Finished Goods</li></ul></li></ul>	<ul style="list-style-type: none"><li>Businesses involved in providing of services and services are intangible</li><li>Do not hold any physical inventory.</li></ul>

## Stages of Manufacturing



Cost: Outflow of resources

## Classification of Cost

### Nature

#### Direct Cost

• Cost which is directly associated or related to production or the cost which can be directly identifiable or traceable to a particular unit cost is defined as 'Direct Cost'

• E.g.: Direct Material

• Direct Labour

• Direct Expenses (Royalties/license cost)

• The sum of all the direct cost is called 'Prime Cost'

• Prime Cost = DM + DL + DE

OR

Prime Cost = DM + DL

#### Indirect Cost

• Cost which is not directly associated or related to production or the cost which cannot be directly identifiable or traceable to a particular unit cost but which is part of 'Cost of Production' is defined as 'Indirect Cost'

• E.g.: Indirect Material

• Indirect Labour

• Rent, Rate, Insurance, Heat, Light, Power, Repair and Maintenance, Depreciation, Supervision/Factory Management Salaries etc.

• The sum of indirect cost is called 'Factory Overheads'

Note :- Factory Overheads will always include production related costs and will not include any non production or office related costs such as admin, selling, marketing etc.

## Basic Calculations

1. Prime Cost = Direct Material + Direct Labour + Direct Expenses

OR

Prime Cost = Direct Material + Direct Labour

2. Cost of Raw Material / Direct Material Consumed

= Opening inventory of RM + Net Purchases of RM (-) Closing Inventory of RM

3. Net Purchases of Raw Material

= Purchases of RM + Carriage on RM (-) Purchases Returns of RM

4. Direct Labour = no. of labour hours worked  $\times$  wage rate/hour

OR

no. of units produced  $\times$  wage rate/unit

Other terminologies for direct labour:

Direct wages / Factory wages / Manufacturing wages / Production wages / workshop wages

Other terminologies for direct Expense:

license cost / Manufacturing Royalties

5. Total Manufacturing Cost = Prime Cost + Factory Overheads

6. Cost of Goods Manufactured / Cost of Production

= Total Manufacturing Cost + Work in Progress Opening (-) Work in Progress closing

7. Transfer Value = Cost of Goods Manufactured + Factory Profit

Manufacturing Statement: The purpose of preparing the manufacturing Statement is to calculate the cost of production and it is also called 'Manufacturing Account'.

# Specimen Format - Manufacturing A/c / Presentation of Manufacturing A/c

Paperwala limited

Manufacturing a/c for the year ended 31 December 2020

	\$	\$
<u>Direct material</u>		
Opening inventory of raw material		12,000
+ purchases of raw material	150,000	
+ carriage on raw material	10,000	
(-) purchases returns of raw material	<u>(8,000)</u>	152,000
(-) Closing inventory of raw material		<u>(4,000)</u>
Cost of raw material (Dm) consumed		160,000
+ Direct labour (DL)		140,000
+ Manufacturing royalties (Direct expense)		<u>20,000</u>
Prime Cost		320,000
+ <u>Factory Overheads</u>		
Indirect material	15,000	
Indirect labour	14,000	
Heat and light	6,000	
Repair and maintenance	5,000	
Depreciation (Plant and machinery)	<u>20,000</u>	<u>60,000</u>
Total Production Cost		380,000
+ Work in progress opening		30,000
(-) work in progress closing		<u>(20,000)</u>
<u>Cost of Goods Manufactured / Cost of Production</u>		<u><u>390,000</u></u>

Paperwala Limited  
Income Statement for year ended 31 Dec. 2020

	\$	\$
Sales Revenue		768,500
(-) Return Inwards		<u>(1,800)</u>
Net Sales		766,700

(-) Cost of Sales

Opening inventory of finished goods	57000	
+ Cost of production/Cost of Goods Manufactured	390000	
+ Purchases of finished goods	2100	
(-) Closing inventory of finished goods	<u>(52000)</u>	<u>(397100)</u>
Gross Profit		<u>369600</u>

(-) Expenses

Admin. Expenses	150000	
Selling and Dist. Expenses	<u>80000</u>	<u>(230000)</u>
Net profit on trading		<u>139600</u>

# CONCEPT OF FACTORY PROFIT

Factory Profit / Manufacturing Profit / Production Profit / Works Profit :

Eg: Trader of T-shirts

Selling Price	\$ 10
(-) Cost	<u>(8)</u>
Trading Profit	<u>2</u>



reflects trading efficiency

Shift to manufacturing



Selling Price	\$ 10
Production Cost	<u>(7)</u>
Profit	3

reflects manufacturing efficiency

\$1  
Factory Profit

\$2  
Trading Profit

Why do business organisation move towards production?

1. Able to produce the product cheaper than the outside supplier
2. Available resources and finance.
3. Expansion and growth
4. Less reliance on outside supplier
5. Customer loyalty.
6. If the business is able produce a better quality product

E.g 2:



<u>Total Profit</u>	\$
Trading profit	5
Factory profit	<u>3</u>
	<u>8</u>

realised from

# INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

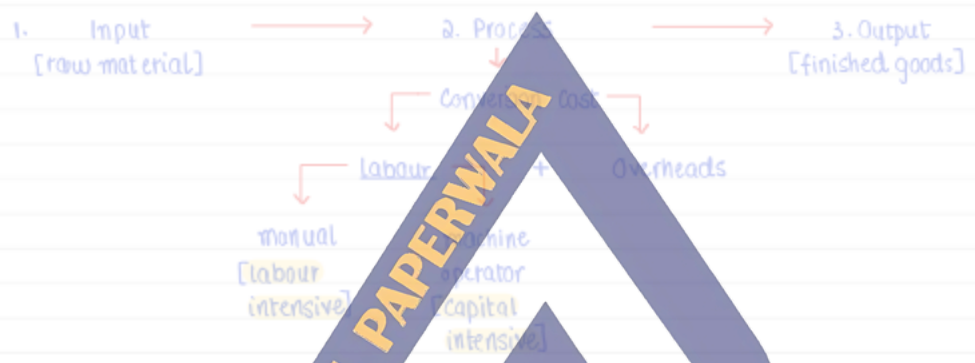
Cost/Expense: Outflow of resources.



# For full content

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## Stages of Manufacturing



Labour intensive business: Business organisations dependant on manual labour rather than technology or machinery.

Capital intensive business: Business organisations which are more dependant on machines rather than manual labour.