COST AND MANAGEMENT ACCOUNTING 2 : THE INTRODUCTION

by
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Binti Azham

knowledge and skills on cost and management accounting techniques which accumulates, classifies, summarizes and reports information to assist management in planning, decision making, control and performance evaluation

2022

PERMISSION TO USE

Cost and Management Accounting 2:
The Introduction

This book contains information submitted by the writer based on her knowledge, experience and expertise in the field of teaching cost and management accounting 2. In addition, this book also contains some information obtained from other parties whose original source is stated through reference. However, since this book only covers topics related to basic elements on cost and management accounting 2, readers are encouraged to refer the contents of other related books to gain a detailed understanding in cost and management accounting 2 polytechnic syllabus.

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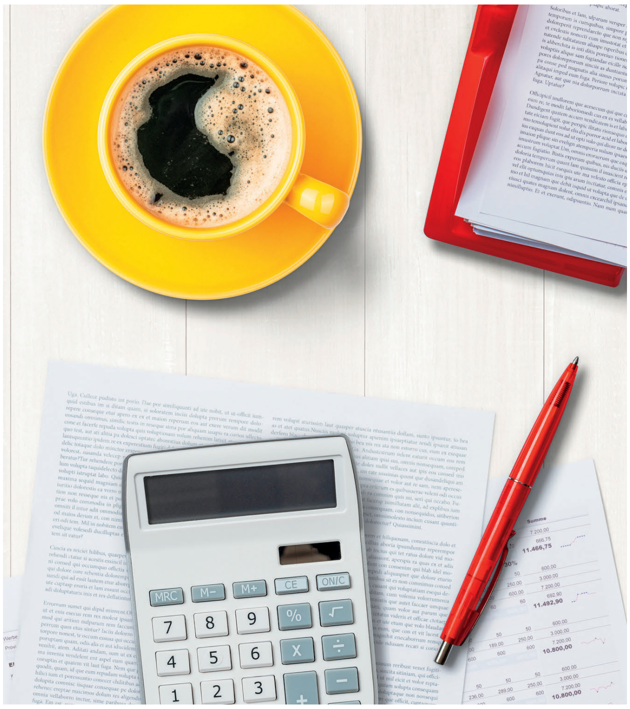
Writer's Foreword

This book provides knowledge and skills on cost and management accounting techniques which accumulates, classifies, summarizes and reports information to assist management in planning, decision making, control and performance evaluation. This book suit with the current Malaysian Polytechnic syllabus on Cost and Management Accounting 2. In order to add knowledge and make them had better understand the cost and management accounting concept.

"MANAGEMENT DECISION MAKING TECHNIQUES FOR BUSINESS DECISION MAKING PURPOSES"

In addition, to make a better understanding on the topic, a conclusion were provided. In the end, may this book may be beneficial to students and others who directly or indirectly used this book as a reference. May all achieve an excellent result during the examination.



Thank you for the ongoing support

Acknowledgements

All praise to Allah subhanahu wa Ta'ala whose help and guidance has sustained to bring this book to completion. I sincerely hope that this book will be a valuable aid and reference to all Commerce Department student's throughout all polytechnics in Malaysia.

I also wish to express my grateful thanks to all parties who involve in the publication process directly or indirectly. There are a lot of moral support, guidance and suggestions given to me during the publication of this book.

Most of all, special thanks are due to my family members who never stop giving their supports and encouragement in getting this book published.

Finally, I wish to express my deepest gratitude to everybody who is always helpful in giving me an idea towards the publication of this book. Without cooperation and support from all parties involved, none of this will ever come true.

Sincerely,
Nur Azreen Azriana Binti Azham

1

MANAGERIAL ACCOUNTING & BUSINESS ENVIRONMENT

Evaluate correctly financial information using management accounting techniques to facilitate planning, decision making, control and measure business performance

Learning Outcomes

01

To underdstand

The nature of cost and management accounting in the globalization management environment

02

To understand

The role of management accounting information in management and decision making process

03

To understand

The importance of ethics in business

04

Summarize

① The Nature of Cost and Management Accounting in the Globalization Management Environment

Globalization is the process by which the international exchange of goods, services, capital, technology and knowledge that can caused management to expand to cross the countries nationwide. Globalization directly affected the management such as in the forms of communication.

Despite that, management accounting prepared reports about business operations that help managers in making decisions that helps a business pursue its goals by identifying, measuring, analyzing, interpreting and communicating information to managers. Manager is the person inside the organizations who directly control the operations of the company.

The need of management accounting is very essential since it has provided important data to run an organization or business in any ways.

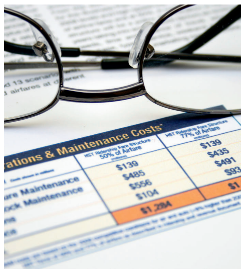
Management Strategies In The Contemporary Business Process

There are many management strategies in the contemporary business process. However, in this topic we will discuss the strategies limited to as seen in below table.

The Balanced Scorecard & Strategy Map

The Value Chain

Activity Based Costing & management

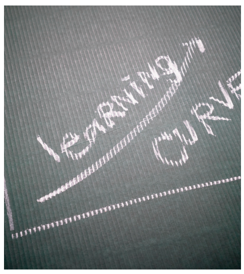


Target Costing

Life-Cycle costing

Total Quality Management

Lean Accounting



Learning Curve Theory

MANAGEMENT STRATEGIES

The term 'strategic management accounting' was introduced in 1981 and was defined as 'the provision and analysis of management accounting data about a business and its competitors, for use in developing and monitoring business strategy. (cimaglobal.com, 2022)

The Balanced Scorecard & Strategy Map

The balanced scorecard is a management system aimed at translating an organization's strategic goals into a set of organizational performance objectives that, in turn, are measured, monitored and changed if necessary to ensure that an organization's strategic goals are met

The Value Chain

a set of activities that a company operating in a specific industry performs in order to deliver a product or services

Activity Based Costing and Management

an approach to the costing and monitoring of activities which involves tracing resource consumption and costing final outputs (CIMA)

MANAGEMENT STRATEGIES

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Lean Accounting

management accounting system for a lean organization. It provides the relevant financial and nonfinancial information necessary to execute the lean strategy and drive financial success

Learning Curve Theory

a graphical representation of the relationship between how proficient someone is at a task and the amount of experience they have

Total Quality Management

an ongoing continuous improvement process to maintain and improve the products and services quality through the time

MANAGEMENT STRATEGIES

The term 'strategic management accounting' was introduced in 1981 and was defined as 'the provision and analysis of management accounting data about a business and its competitors, for use in developing and monitoring business strategy. (cimaglobal.com, 2022)

Target Costing

CIMA defines target cost as "a product cost estimate derived from a competitive market price."

Formula :

Target Costing = Selling Price – Profit Margin

Life Cycle Costing

the process of estimating and compiling all cost spend on an asset over its useful life

The main purpose of accounting Strategic Management Accounting help the organization to achieve its goals. The strategy is a way by its position among competitors and distinguishes itself

② The Role of Management Accounting Information in Management and Decision-Making

MANAGEMENT ACCOUNTING

Management accounting information focused on internal managers and decision makers. The information used to provide financial relevant data to manager's operation in an effort to make a sound business decision. Management accounting information comes in the form of financial ratios, budget forecasts, variance analysis and cost accounting.

Management accounting aims to assist management in planning, controlling and decision making in an organizational activity. It is important that the information provided used in making the right decision.

MANAGEMENT ACCOUNTING INFORMATION DEFINITION

01

Management Accounting is the process of measuring and reporting information about economic activity within organizations, for use by managers in planning, performance evaluation and operational control.

02

Management Accounting mean for internal stakeholders, such as the management team who used the information for the day-to-day operations of a business. The information used to determine sales prices and costs, employee bonuses, raises for employees and other general operation decisions.

*"Every organization has managers.
Someone must be responsible for making plans, organizing resources, directing personal and controlling operations.*

This statement refers to management accounting is very important to management

The Importance of Management Accounting Information to Management in Decision Making

PLANNING

To identify and select the best alternatives that best suit with the organization's objective and specifying how the action will be implemented

IMPLEMENTATION

Provide structure and capacity in which the management duties to achieve from what they have planned.

DIRECTING

Mobilizing people to carry out plans and run routine operations

INVENTORY VALUATION

Involves product costing and the preparation of income statements. Identify areas of wastage and propose remedial actions.

PROFIT DETERMINATION

On the other hand, management need to analyze the effects of alternative courses of action that may relate to identify and manage efficient/inefficient departments/process that lead to identify profitable/unprofitable products or services

PERFORMANCE EVALUATION

Evaluating the profitability of individual products and product lines. Determining the relative contribution of different managers and different parts of the organization.

The Characteristics of An Effective Management Accounting Information System

Management Accounting aims to assist management in planning, controlling and decision making towards organizational activities. It is important that the information provided used in making the right decision. For management accounting information to be valuable to management, it should possess the features presented below.

1

Relevance

Relevance is the concept that the information generated by an accounting system should affect the decision-making of someone perusing the information. The concept can involve the content of the information and/or its timeliness, both of which can influence decision-making

2

Understandable

Information understand well by the managers. Most of the managers do not have a proper background in accounting and finance. Therefore, it is appropriate for management accountant used the accounting term that can be understandable to ensure that the information provided able to use in making the right decision

3

Timely

Information gathered before it happens. If the accounting information received after already done, then no more correct action taken or the decision has no more value.

The Characteristics of An Effective Management Accounting Information System

Management Accounting aims to assist management in planning, controlling and decision making towards organizational activities. It is important that the information provided used in making the right decision. For management accounting information to be valuable to management, it should possess the features presented below.

4

Comparable

The information provided must be compared with the times, locations, functions, departments etc.

Example: Performance of a department with other department or performance of a department in certain of period compared

5

Reliable and complete

Reliable

The reliability principle is the concept only recording transactions that can be verify with objective evidence.

Complete

Information that is gathers and collects without leaving important and useful information.

6

Cost-benefit features

The information provided must provide useful information on returns at least cover the cost of providing such information. In other words, if the costs incurred are higher than the benefits, the information considered bad to company's costing.

Ethics in business process

ETHICAL BEHAVIOR FOR MANAGEMENT ACCOUNTANTS

The ethics requirements reflects management accountants in their diverse responsibilities in serving a variety of constituencies

3 The Importance of Ethics in Business Process

The Code of Conduct for Management Accountant based on Institute of Management Accountants (IMA)

Business ethics exemplify as the standards for morally right and wrong in conducting a business.

Hence, a management accountant who interpret financial information to make business decisions making performs accounting, finance and management jobs with the techniques needed to drive successful businesses. They also provide business data and analysis to managers within organizations to assist in business decision-making and control.

In conjunction with that, management accountant should practice and pursue their actions in the ethical manners.

Many organizations have and create their own standard of ethics that management should followed. On the other hands, Institute of Management Accountants (IMA) have also establish an ethical standard for the management accountants.

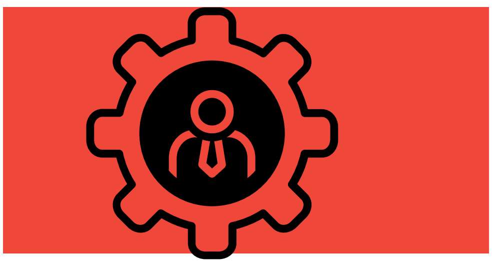
According to IMA the members of IMA shall behave ethically. A commitment to ethical professional practice includes overarching principles that express the values and standards that guide member conduct.

According to IMA on the article IMA Statement of Ethical Professional Practice, 2017, Members of IMA shall behave ethically. A commitment to ethical professional practice includes overarching principles that express our values and standards that guide member conduct.

Principles
IMA's overarching ethical principles include:
Honesty, Fairness, Objectivity, and Responsibility. Members shall act in accordance with these principles and shall encourage others within their organizations to adhere to them.

Standards
IMA members have a responsibility to comply with and uphold the standards of Competence, Confidentiality, Integrity, and Credibility. Failure to comply may result in disciplinary action

COMPETENCE



CONFIDENTIALITY

INTEGRITY

CREDIBILITY

The Explanations :

COMPETENCE

1. Maintain an appropriate level of professional leadership and expertise by enhancing knowledge and skills.

2. Perform professional duties in accordance with relevant laws, regulations, and technical standards.

3. Provide decision support information and recommendations that are accurate, clear, concise, and timely. Recognize and help manage risk.

CONFIDENTIALITY

1. Keep information confidential except when disclosure is authorized or legally required.

2. Inform all relevant parties regarding appropriate use of confidential information. Monitor to ensure compliance.

3. Refrain from using confidential information for unethical or illegal advantage.

INTEGRITY

1. Mitigate actual conflicts of interest. Regularly communicate with business associates to avoid apparent conflicts of interest. Advise all parties of any potential conflicts of interest.

2. Refrain from engaging in any conduct that would prejudice carrying out duties ethically.

3. Abstain from engaging in or supporting any activity that might discredit the profession.

4. Contribute to a positive ethical culture and place integrity of the profession above personal interests.

CREDIBILITY

1. Communicate information fairly and objectively.

2. Provide all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.

3. Report any delays or deficiencies in information, timeliness, processing, or internal controls in conformance with organization policy and/or applicable law.

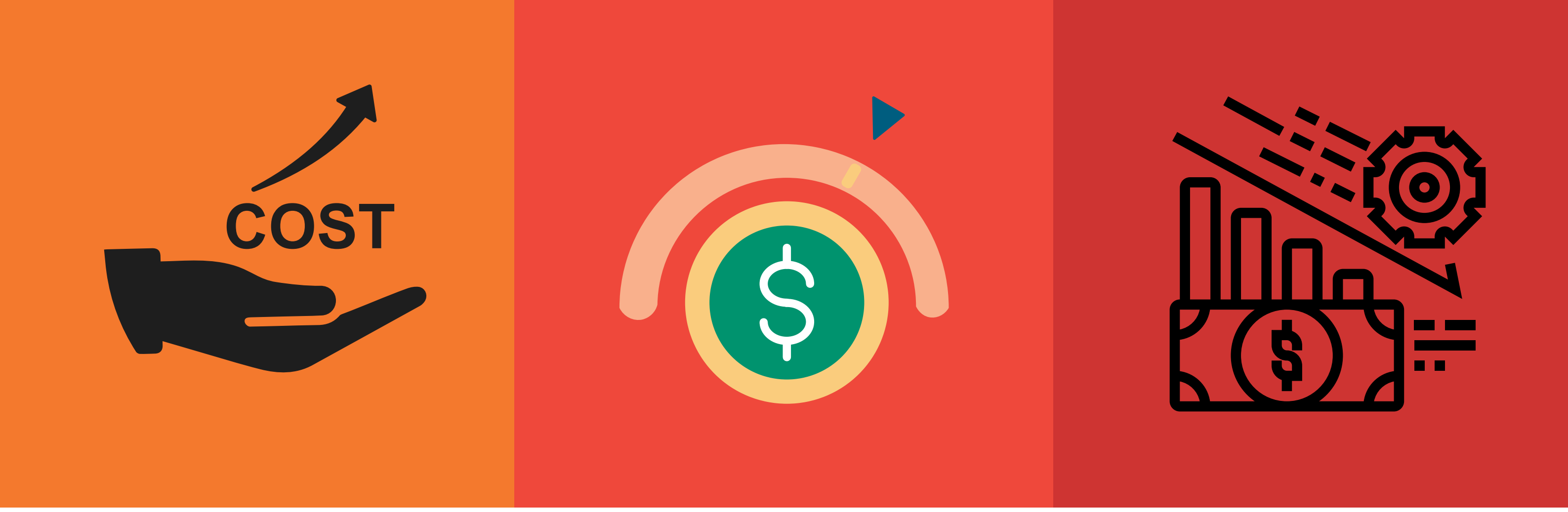
4. Communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity

4 SUMMARY

Managerial Accounting assist managers in carrying out their responsibilities, which include planning, directing and motivating, and controlling.

Since managerial accounting geared to needs of managers rather than to the need of outsiders, it differs substantially from financial accounting. Managerial accounting is oriented more towards to the future, places less emphasis on precision, emphasis segments of an organizations (rather than organizations as a whole), is not governed by generally accepted accounting principles, and is not mandatory.

Management Accountant in the other ways must originally performs their job task by followed the code of conducts for management accountant based on IMA.



2

PRICING
DECISIONS

Evaluate correctly financial information using management accounting techniques to facilitate planning, decision making, control and measure business performance

Learning Outcomes

01

To underdstand

The process of making decisions by considering pricing for products and services

02

To determine

The computation of the selling price of product and services

03

To apply

Target costing in pricing decisions

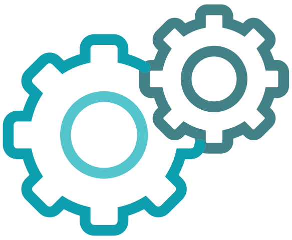
04

Summarize

1 Process of Making Decisions by Considering Pricing of Products and Services

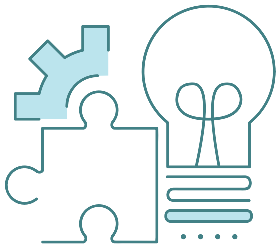
Pricing strategies are important for companies to set the right price to maximize sales and profit. Company can choose the most suitable strategies that can help them to achieve their goals and objectives.

Objectives of Pricing



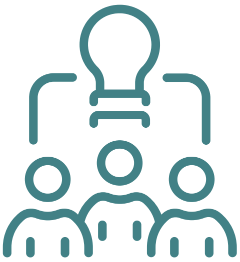
1

To set a consistent target for long term of period, in order for business to sustain in the economy and obtain shares in the market



2

To make sure the consistency of price in the market in order to maintain price stability



3

To establish profit margin that directly associate to sales and cost

4

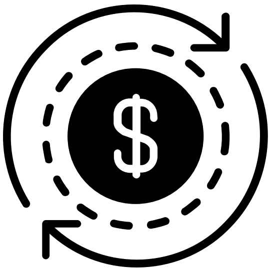
To meet the competition of others competitors in the market and able to sustain in long run

Factors that influence the pricing of products or services

Pricing decisions are the decisions a business make when setting process for their products or services.

Pricing a product or services considered part of a company marketing strategies because it influences its relationship with customers. When prices are fair and competitive, customers come back, increasing the profitability of the business.

In making pricing decisions there are few factors influence the decisions.

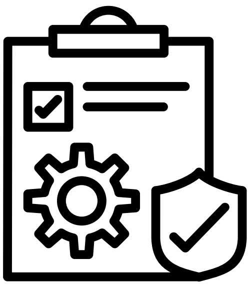


1

The required rate of return/the level of profit required

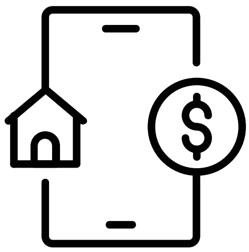
2

Acceptable level of price setting/ the ancitipated price by customers



3

The appropriate quality/condition of product/service

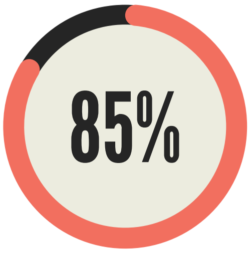


4

The factors of demand and supply

5

The presence of replacement/ number of competitors in the market



Price elasticity

Measures the sensitivity or responsiveness of the quality demanded due to a change in its price. It also defined as ratio of the rate of changes in quantity demanded to changes in its price.

The Formula

$$\textbf{Formula for PED} = \frac{\textbf{Changes in quantity of demand}}{\textbf{Changes in Price}}$$

$$\boxed{\frac{Q1-Q0}{Q0} \times \frac{P0}{P1-P0}}$$

Q1 = New Quantity Demanded
Q0 = Original Quantity Demanded
P0 = Original Price
P1 = New Price

The example

The quantity demand for pencils is 10 when the price is RM4. But the if the price increase to RM6, the quantity demand decrease to 6.
Determine the price elasticity of demand for pencil

Solution:

$$= \frac{Q_1 - Q_0}{Q_0} \times \frac{P_0}{P_1 - P_0}$$

$$= \frac{6 - 10}{10} \times \frac{4}{6 - 4}$$

$$= 0.8$$

Why is price elasticity of demand important?

Knowing the price elasticity can offer insight into how a market will react to price changes. This is important for businesses that are making pricing decisions as raising or lowering prices will directly impact the number of sales. Factoring price elasticity of demand is a key step for companies to determine the right pricing objectives within their niche. (Vivian, 2022)

To understand price elasticity

If a product's requested quantity experiences a substantial shift in response to price increases, it is called "elastic", i.e. quantity extended far from its preceding level. If the purchased quantity has a slight change in response to its size, it is called "inelastic" or quantity has not extended dramatically from its preceding level.

The easier a shopper can replace one product with a rising price for another, the more the price will drop, becomes "elastic". In other words, in a world where people like coffee and tea equally, if the price of coffee goes up, people will have no problem switching to tea, and so the demand for coffee will drop. That is because coffee and tea are seen as good alternatives to each other.

The more discretionary a transaction is, the higher the elasticity; the more the quantity will decrease in response to price increases. So, if you're considering purchasing a new washing machine, but the existing one is still working (it's just old and outdated).

If the costs of new washing machines are rising, you're likely to skip the immediate purchase and just wait until prices go down or when the existing machine completely stops working

retrieved from : https://cleartax.in/g/terms/price-elasticity-of-demand

Pricing Strategies

Pricing strategy is a techniques that an organization use to price their products or services. Most of the organizations, large or small, base the price of their products and services on production, labor and advertising expenses and then add on a certain percentage so they can make a profit. In this book we will discuss the pricing strategies as follows:

01

Full Cost-plus pricing

02

Marginal Cost-plus pricing

03

Relevant Cost

04

Price Skimming

05

Penetration Pricing

06

Complementary Product

07

Product-line Pricing

08

Differential or Price Discrimination

Full Cost Plus Pricing

Price-setting method under which you add together the direct material cost, direct labour cost, selling and administrative costs, and overhead costs for a product, and add to it a mark-up percentage (to create a profit margin) in order to derive the price of the product.

This method commonly used in situations where products and services provided based on the specific requirements of the customer

Marginal Cost-plus pricing

Marginal cost pricing is the practice of setting the price of a product at or slightly above the variable cost to produce it. This approach typically relates to short-term price setting situations. This situation usually arises in either of the following circumstances:

i.A company has a small amount of remaining unused production capacity available that it wishes to use (which a company is more likely to be financially healthy - it simply wishes to maximize its profitability with a few more unit sales) ; or

ii.A company is unable to sell at a higher price (one of desperation, where a company can achieve sales by no other means, the sales are intended to be on an incremental basis; they are not intended to be a long-term pricing strategy, since prices set this low cannot be expected to offset the fixed costs of a business)

Relevant Cost

A relevant cost is a cost that only relates to a specific management decision, and which will change in the future because of that decision. The relevant cost concept is extremely useful for eliminating extraneous information from a particular decision-making process.

In addition, by eliminating irrelevant costs from a decision, management prevented from focusing on information that might otherwise incorrectly affect its decision.

Complementary Products

Method in which one of the products priced to maximize the sales volume and which in turn stimulates the demand of other product. One product is priced low, just to cover the costs with little or no profit margin while the other product is priced high with a very high profit margin.

For example Printer & cartridge. This strategy is successful because once you have bought a printer; you are required to buy the complementary cartridge unless you are willing to buy in a new printer itself. Also, companies avoid competitors selling ink for their printers by having unique cartridges.

Price Skimming

Pricing strategy in which a marketer sets a relatively high initial price for a product or service at first, then lowers the price over time.

It is a temporal version of price discrimination/yield management. It allows the firm to recover its sunk costs quickly before competition steps in and lowers the market price.

Penetration Pricing

Strategy used by businesses to attract customers to a new product or service by offering a lower price during its initial offering.

The lower price helps a new product or service penetrate the market and attract customers away from competitors.

Product-line Pricing

Product line pricing involves the separation of goods and services into cost categories in order to create various perceived quality levels in the minds of consumers.

Product line is a group of related products, differentiating by features and price. Setting products at different price points allows the would-be customers to orient themselves towards the one most likely to fit their needs and spending capabilities.

Differential or Price Discrimination

A selling strategy that charges customers different prices for the same product or service, based on what the seller thinks they can get the customer to agree to.

In pure price discrimination, the seller charges each customer the maximum price he or she will pay.

What is 'Pricing Strategies'

Price is the value that is put to a product or service and is the result of a complex set of calculations, research and understanding and risk taking ability. A pricing strategy takes into account segments, ability to pay, market conditions, competitor actions, trade margins and input costs, amongst others. It is targeted at the defined customers and against competitors.

Retrieved from : https://economictimes.indiatimes.com/definition/pricing-strategies

2 The Computation Of The Selling Price Of A Product And Services Process

Determining pricing is one of the toughest decisions a business owner ever faces. Price too high and inventory does not move; price too cheap and profits are difficult to gain.

Marginal Cost Pricing

Marginal cost pricing designed to move inventory fast while on the other hand full-cost pricing is an ordinary strategy that reflects the overhead into the product pricing.

Marginal Cost-Plus Pricing	Full Cost Pricing
The incremental costs incurred in producing additional units of a good or service. **Only variable costs** charged to cost units and fixed costs of the period written off in full against the aggregate contribution.	Price-setting method under which you add together **all the cost** involved in making a product or services All fixed and variable **costs** are used to compute the total **cost** per unit.

Both approaches are functional under the right situations, and each provide contrast objective for the business. An example on how both approaches underline the different solution stated as examples.

The Example

A company produce metal chair and distribute them all over west Malaysia. The management accountant prices the product at cost plus. The following are related data for the production:

Element of cost	Cost	Cost per unit
Materials	RM40/kg	RM80
Direct labor	RM30/hour	RM45
Manufacturing Overhead	40% is fixed	RM40
Administrative Overhead	30% is variable	RM20

“The company expects a profit margin of 20%. Calculate the price per unit product using:

a) Marginal Cost-plus Pricing
b) Full-cost Pricing”

The Solution

a) Marginal Cost-plus Pricing

Marginal Cost	=	RM80 + RM45 + (RM40 x 60%) + (RM20 x 30%)
	=	RM155
Price	=	RM155 + (RM155 x 20%)
	=	RM186

b) Full-cost Pricing

Total Cost	=	RM80 + RM45 + RM40+ RM20
	=	RM185
Price	=	RM185 + (RM185 x 20%)
	=	RM222

The Optimum Selling Price And Quantity For An Organization, Equating Marginal Cost And Marginal Revenue

Optimum selling price is the price at which profit is maximized that considered both fixed and variable costs calculated in determining the selling price.

In other word, when marginal cost equals to marginal revenue, profit is maximized. Thus, on the point of marginal revenue is greater than marginal cost that means profit would increase

Profit Maximization

MARGINAL REVENUE = MARGINAL COSTS

The Example

A company currently using profit-maximizing price based on Marginal Revenue and Marginal Cost. The management accountant provide the data regarding their company as below:

Unit Produced	Price(RM) / unit Average Revenue	Marginal Revenue/unit (RM)	Marginal Cost/unit (RM)	Total Cost(RM)
10	16	16	10	180
20	14	12	6	200
30	12	8	8	220
40	10	4	9	280
50	8	0	13	300
60	6	-4	16	260
70	4	-8	20	220

Calculate the optimum selling price and quantity using marginal revenue and marginal cost approach

The Solution

Unit Produced	Price(RM) / Average Revenue	Marginal Revenue(RM)	Marginal Cost(RM)	Total Cost(RM)
10	16	16	10	180
20	14	12	6	200
30	12	8	8	220
40	10	4	9	280
50	8	0	13	300
60	6	-4	16	260
70	4	-8	20	220

Marginal Revenue = Marginal Cost = 8

Optimum Price = RM12
ptimum Unit Produce = 30 units

Maximum Profit = Total Revenue – Total Cost
= (30 units x RM12) – RM220
= RM140

Prices and Output Levels For Profit Maximization Using The Demand Based Approach To Pricing

Demand Based Pricing is a pricing method based on the customer's demand and the perceived value of the product. In this method the customer's responsiveness to purchase the product at different prices is compared and then an acceptable price is set. Some of the approach use by company is as follows:

a) **Price Skimming** – Electronic products (Initial price is set very high, then the price is reduced gradually – discounted price at Lazada, Shopee)

b) **Price Discrimination** – Airline ticket prices (different price for different date, tickets during holiday season would be costlier than off season)

c) **Price Penetration** – Discounts, inaugural price, first 100 buyers

The price set for product will be different for each circumstance. While the production quantity will be based on the demand of the product at that period.

3 Target Costing in Pricing Decision

Target costing is a system under which a company plans for the price points, product costs, and margins that it wants to achieve for a new product. If it cannot manufacture a product at these planned levels, then it cancels the design project entirely.

With target costing, a management team has a powerful tool for continually monitoring products from the moment they enter the design phase and onward throughout their product life cycles.

Considered one of the most important tools for achieving consistent profitability in a manufacturing environment.

Target costing is most applicable to companies that compete by continually issuing a stream of new or upgraded products into the marketplace (such as consumer goods)

the formula

target profit = anticipated Selling Price – Desired Profit

A firm could address the problems discussed above through the implementation of target costing:

- The first step is to establish a competitive market price. The company would consider how much customers are willing to pay and how much competitors are charging for similar products.
- Determine the required profit
- A target cost is arrived at by deducting the required profit from the selling price
- Steps must then be taken to close the target cost gap from the current cost per unit if higher.

Whereas, the target cost gap is the differences between estimated cost and the target cost. Estimated cost is the calculation of the probable cost of a product or project, based on information relating to the price of materials, labour, etc.

the formula

Target Cost Gap = Estimated Cost – Target Cost

Benefits of Target Costing

Highlight 1

It encourages management to continously improve process and innovate to gain a competitive cost advantage.

Highlight 2

It is customer-centric as company creates product from customers' expectation. This expectation could be from price or feature perspective or both.

Highlight 3

Creates economies of scale because of continuous improvement from time to time

Highlight 4

Company becomes proactive in converting new market opportunities into real saving. It assists the company in delivering the best value for money to the stakeholders

Limitation of Target Costing

Highlight 1

Development process is lengthy as product has to go through several alterations to meet the target cost

Highlight 2

Difficult to reach consensus, as this involves contribution of several people

Highlight 3

Reducing cost may hurt employees' morale

Highlight 4

Project team has to work tirelessly to meet target cost

Target Selling Price and Target Cost Calculation

Profit margin is ***based on selling price***, target total cost can be calculated as follows:

Target cost
= Selling Price – (Profit % × Selling Price)

While, profit margin is ***based on cost,*** target cost can be found as follows:

Target cost

$$= \frac{\text{Selling Price}}{1 + \text{Profit \%}}$$

The Example

A company and manufactures pencils that operates in a very competitive environment. It sells pencils to different educational institutions in Malaysia. The company only can charge RM2 per unit.

a) If the company's intended profit margin is 15% on sales calculate the target cost per unit.

b) If the company's intended profit margin is 15% on cost, calculate the target cost per unit.

The Solution

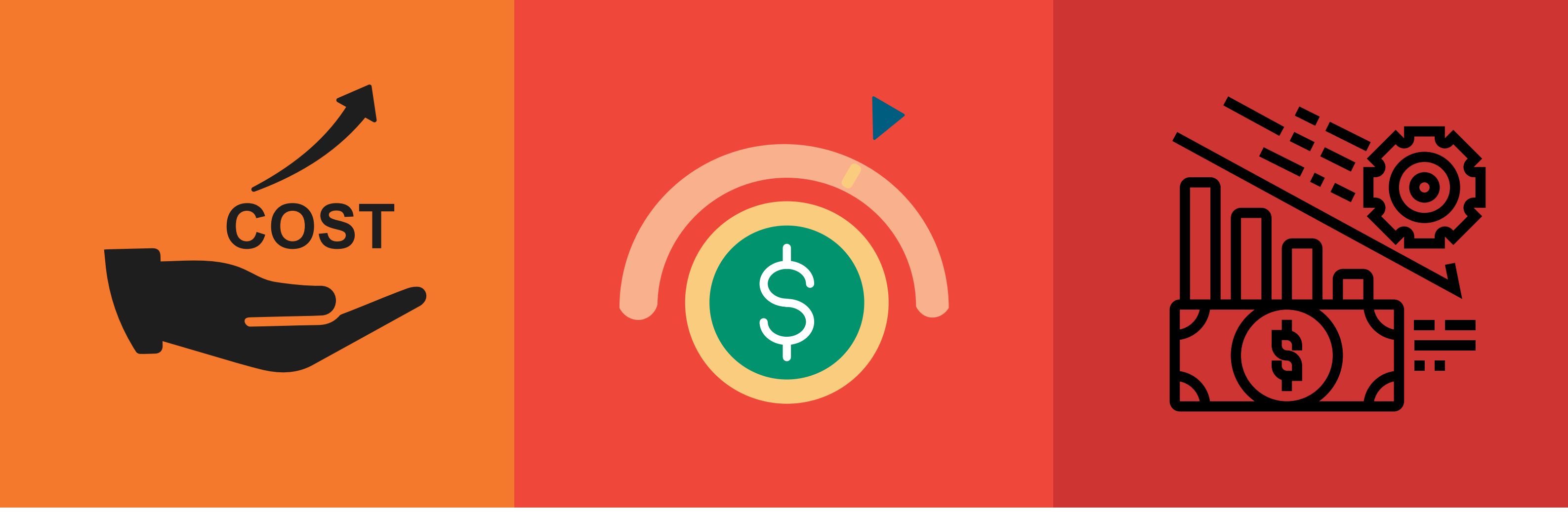
a)	Target cost	=	Selling Price – (Profit % × Selling Price)
		=	RM2 – (15% x RM2)
		=	RM1.70
b)	Target cost	=	Selling Price ÷ (1 + Profit %)
		=	RM2 ÷ (1 + 15%)
		=	RM1.74

4 SUMMARY

Pricing involves a delicate balancing act. Higher prices result in more revenue per unit but drive down unit sales. Exactly where to set prices to maximize profit is a difficult problem, but, in general, the mark-up over cost should be highest for those products where customers are least sensitive to price.

From the economists' point of view, the cost base for the mark-up should be variable cost. In contrast, in the absorption costing approach the cost base is the absorption costing unit product cost and the mark-up computed to cover both nonmanufacturing costs and to provide an adequate return on investment.

Some companies take a different approach to pricing. Instead of starting with costs and then determining prices, they start with prices and then determine allowable costs. Companies that use target costing estimate what a new product's market price is likely to be based on its anticipated features and prices of products already on the market. They subtract desired profit from the estimated market price to arrive at the product's target cost.



3

DISCUSSION AND ANALYSIS

Managerial Accounting & Business environment

Discussion and Analysis

Managerial Accounting & Business environment

Analysis

The management accounting and the importance

Discussion on

The management strategies in the contemporary business process

Justify

The needs of management accounting information

Identify

The characteristics of good management accounting information

50%

Review

Code of conduct for management accountant based on Institute Management of Accountant that include the principles and the standards

50%

Analysis

Important of practising good ethical manner

ANSWER

Discussion and Analysis

Analysis

The management accounting and the importance

Answer

Management Accounting is the process of measuring and reporting information about economic activity within organizations, for use by managers in planning, performance evaluation and operational control.

The importance of management accounting are :

1. Planning: To identify alternatives and then to select from among the alternatives the one that does the best job of furthering the organization's objective.
2. To Evaluating the profitability of individual products and product lines.
3. Controlling: Managers ensure that the plan is being followed.
4. Identify and manage efficient/inefficient departments/process
5. Identify profitable/unprofitable products or services
6. Identify areas of wastage and propose remedial actions
7. Analyse the effects of alternative courses of action

Discussion on

The management strategies in the contemporary business process

Answer

Strategic management is the ongoing planning, monitoring, analysis and assessment of all necessities an organization needs to meet its goals and objectives. Changes in business environments will require organizations to constantly assess their strategies for success. The management strategies include the balanced scorecard and strategy map, the value chain, activity based costing management, target costing, life-cycle costing, total quality management, lean accounting, learning curve theory and many more.

Discussion and Analysis

Justify

The needs of management accounting information

Answer

Management Accounting provides deep insight into details of your company finance and resource flow so you could reach a timely decision based on actual data. It separates what's important, detects flaws, and provides means to form long-term strategies to scale your business. Management accounting information need because :

1. Helping in implementing Relevant Cost Analysis
2. Making effective production decisions
3. Planning future business development
4. Making a proper budget decisions
5. Rational resource consumption ability

Identify

The characteristics of good management accounting information

Answer

Management Accounting aims to assist management in planning, controlling and decision making towards organizational activities. It is important that the information provided used in making the right decision.

For management accounting information to be valuable to management, it should possess these characters. Relevance, understandable, timely, comparable, reliable and complet, with cost benefit features and relevance.

Discussion and Analysis

<u>Review</u>

Code of conduct for management accountant based on Institute Mana[illegible] of Accountant that include the principles and the standards

<u>Answer</u>

A commitment to ethical professional practice includes four principle swhich are Honesty, Fairness, Objectivity and Responsibility. All the IMA's members shall act in accordance with these principles and shall encourage others within their organizations to adhere to them

Hence the Standards include Competence, Confidentiality, Integrity and Credibility.

<u>I. COMPETENCE</u>
Maintain an appropriate level of professional leadership and expertise by enhancing knowledge and skills. Perform professional duties in accordance with relevant laws, regulations, and technical standards. Provide decision support information and recommendations that are accurate, clear, concise, and timely. Recognize and help manage risk.

<u>II. CONFIDENTIALITY</u>
Keep information confidential except when disclosure is authorized or legally required. Inform all relevant parties regarding appropriate use of confidential information. Monitor to ensure compliance. Refrain from using confidential information for unethical or illegal advantage.

<u>III. INTEGRITY</u>
Mitigate actual conflicts of interest. Regularly communicate with business associates to avoid apparent conflicts of interest. Advise all parties of any potential conflicts of interest. Refrain from engaging in any conduct that would prejudice carrying out duties ethically. Abstain from engaging in or supporting any activity that might discredit the profession. Contribute to a positive ethical culture and place integrity of the profession above personal interests.

<u>IV. CREDIBILITY</u>
Communicate information fairly and objectively. Provide all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations. Report any delays or deficiencies in information, timeliness, processing, or internal controls in conformance with organization policy and/or applicable law. Communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.

Discussion and Analysis

Analysis

Important of practicing good ethical manner

Answer

An organization that is perceived to act ethically by employees can realize positive benefits and improved business outcomes. The perception of ethical behavior can increase employee performance, job satisfaction, organizational commitment, trust and organizational citizenship behaviors.

The reputation of a business in the surrounding community, among other businesses, and for individual investors is paramount in determining whether a company is a worthwhile investment. If a company is perceived to operate unethically, investors are less inclined to buy stock or otherwise support its operations.

By behaving according to a high ethical standard, companies can strengthen the drive to succeed internally among executives, management teams, and staff. Furthermore, companies can attract and keep investors who themselves are attracted to companies that align with their own standards of ethical behavior. In other words, business ethics can help companies build long-lasting, solid reputations and financial success.

Retrieved from investopedia.com (2022) The Importance of Business Ethics

Pricing Desicions

Discussion and Analysis

Pricing Decisions

Identify

Objectives of pricing

Underline

Factors that influence pricing

Analyze

Lilola Sdn Bhd assembles and sells many types of oil perfume. It is considering extending its product range to include water perfume. These water perfume produce a better quality than current perfume production and have a huge number of potential.

Assembly workers assembling a variety of liquid materials to produce a water perfume. Production overheads are currently absorbed into product costs on an assembly labor hour basis.

Lilola Sdn Bhd is considering a target costing approach for its water perfume

To analyze
a) The target costing process that Lilola Sdn Bhd should undertake

b) The benefits to Lilola Sdn Bhd of adopting a target costing approach at such an early stage in the product development process

c) Assuming a cost gap identified in the process outline possible steps Lilola Sdn Bhd could take to reduce this gap

Discussion and Analysis

Pricing Decisions

Identify

Target costing and how do target costs enter the pricing decision

Determine

Aini Enterprise developed a brand-new furniture sold at RM1,800 per unit. Management demand a profit of 65% on the selling price. Calculate the target cost of this product

Evaluate

Orange Bhd produces a product named "Yummylicious". Maximum demand for the product is 12,000 units per annum. Demand will reduce by 40 units for every RM1 increase in the selling price. Orange Bhd has calculated that the profit-maximizing selling price for the coming year will be RM15. Compute the profit-maximizing sales level in units.

Explain

The price elasticity of demand and profit maximization

Discussion and Analysis

Pricing Decisions

Acknowledge

A selling price of RM44 has been set in order to compete with a similar radio on the market that has comparable features to Edward Limited's intended product. The board have agreed that the acceptable margin (after allowing for all production costs) should be 20%. Cost information for the new radio is as follows:

i. Component 1 (Circuit board) – these are bought in and cost RM4.10 each. They are bought in batches of 4,000 and additional delivery costs are RM2,400 per batch.

ii. Component 2 (Wiring) – in an ideal situation 25 cm of wiring is needed for each completed radio. However, there is some waste involved in the process as wire is occasionally cut to the wrong length or is damaged in the assembly process. Edward Limited estimates that 2% of the purchased wire is lost in the assembly process. Wire costs RM0·50 per metre to buy.

iii. Other material – other materials cost RM8.10 per radio.

iv. Assembly labour – these are skilled people who are difficult to recruit and retain. Edward Limited has more staff of this type than needed but is prepared to carry this extra cost in return for the security it gives the business. It takes 30 minutes to assemble a radio and the assembly workers are paid RM12.60 per hour. It is estimated that 10% of hours paid to the assembly workers is for idle time.

v. Production Overheads – recent historic cost analysis has revealed the following production overhead data:

Total production overhead (RM) Total assembly
(labour hours)
Month 1 620,000 19,000
Month 2 700,000 23,000

Fixed production overheads are absorbed on an assembly hour basis based on normal annual activity levels. In a typical year, Edward Limited will work 240,000 assembly hours.

Calculate the expected cost per unit for the radio and identify any cost gap that might exist

ANSWER

Discussion and Analysis

Identify

Objectives of pricing

Answer

1. To set a consistent target for short term period, in order for business to sustain in the economy
2. To obtain/increase share in the market
3. To make sure the consistency of price in the market in order to maintain price stability
4. To establish profit margin that directly associate to sales and cost
5. To meet the competition of other competitors in the market

Underline

Factors that influence pricing

Answer

1. The required rate of return /the level of profit required
2. The appropriate quality/condition of the product/service
3. Acceptable level of price setting / the anticipated price by customer
4. The factors of demand and supply
5. The presence of replacement / number of competitors in the market

Discussion and Analysis

Analyze

a) The target costing process that Edward Limited should undertake

ANSWER

Target costing begins by specifying a product an organisation wishes to sell. This will involve extensive customer analysis, considering which features customers value and which they do not. Ideally only those features valued by customers will be included in the product design.

The price at which the product can be sold at is then considered. This will take in to account the competitor products and the market conditions expected at the time that the product will be launched. Hence a heavy emphasis is placed on external analysis before any consideration is made of the internal cost of the product.

From the above price a desired margin is deducted. This can be a gross or a net margin. This Leaves the cost target. An organisation will need to meet this target if their desired margin is to be met.

Costs for the product are then calculated and compared to the cost target mentioned above. If it appears that this cost cannot be achieved then the difference (shortfall) is called a cost gap. This gap would have to be closed, by some form of cost reduction, if the desired margin is to be achieved.

Discussion and Analysis

Analyze

b) The benefits to Lilola Sdn Bhd of adopting a target costing approach at such an early stage in the product development process

ANSWER

The organization will have an early external focus to its product development. Businesses have to compete with others (competitors) and an early consideration of this will tend to make them more successful. Traditional approaches (by calculating the cost and then adding a margin to get a selling price) are often far too internally driven.

Only those features that are of value to customers will be included in the product design. Target costing at an early stage considers carefully the product that is intended. Features that are unlikely to be valued by the customer will be excluded. This is often insufficiently considered in cost plus methodologies.

Cost control will begin much earlier in the process. If it is clear at the design stage that a cost gap exists then more can be done to close it by the design team. Traditionally, cost control takes place at the cost incurring' stage, which is often far too late to make a significant impact on a product that is too expensive to make.

Costs per unit are often Lower under a target costing environment. This enhances profitability. Target costing has been shown to reduce product cost by between 20% and 40% depending on product and market conditions. In traditional cost plus systems an organization may not be fully aware of the constraints in the external environment until after the production has started. Cost reduction at this point is much more difficult as many of the costs are designed in' to the product.

it is often argued that target costing reduces the time taken to get a product to market. Under traditional methodologies there are often lengthy delays whilst a team goes 'back to the drawing board'. Target costing, because it has an early external focus, tends to help get things right first time and this reduces the time to market.

Discussion and Analysis

Analyze

c) Assuming a cost gap identified in the process outline possible steps Lilola Sdn Bhd could take to reduce this gap

Answer

I. Review water perfume features

Remove features from the perfume that add to cost but do not significantly add value to the product when viewed by the customer. This should reduce cost but not the achievable selling price. This can be referred to as value engineering or value analysis.

II. Team approach

Cost reduction works best when a team approach is adopted. Lilola Sdn Bhd should bring together members of the marketing, design, assembly and distribution teams to allow discussion of methods to reduce costs. Open discussion and brainstorming are useful approaches here.

III. Review the whole supplier chain

Each step in the supply chain should be reviewed, possibly with the aid of staff questionnaires, to identify areas of likely cost savings. Areas which are identified by staff as being likely cost saving areas can then be focussed on by the team. For example, the questionnaire might ask 'are there more than five potential suppliers for this component?' clearly a 'yes' response to this question will mean that there is the potential for tendering or price competition.

IV. Components

Lilola Sdn Bhd should look at the significant costs involved in components. New suppliers could be sought or different materials could be used. care would be needed not to damage the perceived value of the product. Efficiency improvements should also be possible by reducing waste or idle time that might exist. Avoid, where possible, non-standard parts in the design.

Discussion and Analysis

Identify

Target costing and how do target costs enter the pricing decision

Answer

Target costing is a system under which a company plans for the price points, product costs, and margins that it wants to achieve for a new product. If it cannot manufacture a product at these planned levels, then it cancels the design project entirely. With target costing, a management team has a powerful tool for continually monitoring products from the moment they enter the design phase and onward throughout their product life cycles

Determine

Aini Enterprise developed a brand-new furniture sold at RM1,800 per unit. Management demand a profit of 65% on the selling price. Calculate the target cost of this product

Answer

= Selling Price – (Profit % x Selling Price)

= RM1800 – (65% x RM1800)

= RM1800 – RM1170

= **RM630 (Target Cost)**

Discussion and Analysis

Evaluate

Orange Bhd produces a product named "Yummylicious". Maximum demand for the product is 12,000 units per annum. Demand will reduce by 40 units for every RM1 increase in the selling price. Orange Bhd has calculated that the profit-maximizing selling price for the coming year will be RM15. Compute the profit-maximizing sales level in units.

Answer

RM15 x 40 unit = 600 unit

Maximum units = 12,000 units – 600 units

= 11,400 units

Explain

The price elasticity of demand and profit maximization

Answer

Price Elasticity of demand measures the sensitivity/ responsiveness of the quantity demanded due to a change in its price. It also defined as ratio of the rate of changes in quantity demanded to changes in its price.

Discussion and Analysis

Acknowledge

Calculate the expected cost per unit for the radio and identify any cost gap that might exist

Answer

solution 1

Workings		
Variable Cost Per Unit Using the High/Low Method		
Overhead 1	RM620000	
Overhead 2	RM(700000)	
Difference		RM(80000)
Assembly Hours in Month 1	19000	
Assembly Hours in Month 2	(23000)	
Difference		(4000)
Variable Cost Per Hour	(RM80000/4000hours)	20

Workings		
Absorption Rate for Fixed Costs		
Total Costs in Month 1		RM620000
Total Variable Costs	(19000hours x RM20)	RM380000
Total Fixed Costs per Month	(RM620000 - RM380000)	RM240000
Total Fixed Costs per year	(RM240000 x 12months)	RM2880000
Total Assembly Hours per Year		240000 hours
Absorption Rate	(RM2880000/240000hours)	RM12 per hour

Cost Gap Calculation		
		RM
Component 1	(RM4.10 + (RM2400/4000 units)	4.70
Component 2	(25cm/100cm x RM0.50 x 100/98)	0.128
Other Material		8.10
Assembly Labour	(30min/60min x RM12.60 x 100/90)	7
Variable Overheads	(30min/60min x RM20 per hour)	10
Fixed Production Overheads	(30min/60min x RM12 per hour)	6
Total Cost		**35.928**
Desired Cost	(RM44 x 80%)	35.2
Cost Gap		0.728

Discussion and Analysis

Acknowledge

Calculate the expected cost per unit for the radio and identify any cost gap that might exist

Answer

solution 2

Workings		
Variable Cost Per unit using the High/Low method		
Overheads in Month 1	620,000	
Overheads in Month 2	700,000	
Difference		80,000
Assembly Hours in Month 1	19,000	
Assembly Hours in Month 2	23,000	
Difference		4,000
Variable cost per unit	(80,000 / 4,000)	20

Workings		
Absorption Rate for Fixed Costs		
Total Costs in Month 1		620,000
Total Variable Costs	(19,000 x 20)	380,000
Total Fixed Costs per month	(620,000 - 380,000)	240,000
Total Fixed Costs per year	(240,000 x 12)	2,880,000
Total Assembly Hours per year	In question	240,000
Absorption Rate	(2,880,000 / 240,000)	$12 per hour

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