



# UNIT 13: MANAGING FINANCIAL PRINCIPLES AND TECHNIQUES

*LECTURER: Judith Robb-Walters*

# UNIT 13: MANAGING FINANCIAL PRINCIPLES AND TECHNIQUES



gg59799318 www.gograph.com

- LO1 : BE ABLE TO APPLY COST CONCEPTS TO THE DECISION MAKING PROCESS

# THE BASIC SYLLABUS



- 1. Be able to apply cost concepts to the decision making process.
- 2. Be able to apply forecasting techniques to obtain information for decision making.
- 3. Be able to participate in the budgetary process of an organisation.
- 4. Be able to recommend cost reduction and management processes for an organisation.
- 5. Be able to use financial appraisal techniques to make strategic investment decisions for an organisation.
- 6. Be able to interpret financial statements for planning and decision making.

# LEARNING OBJECTIVES



At the end of the class students should be able to:



Explain the importance of costs in the pricing strategy of an organisation

# OVERVIEW



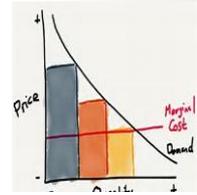
- The decision-making process begins when a manager identifies the real problem. The accurate definition of the problem affects all the steps that follow; if the problem is inaccurately defined, every step in the decision-making process will be based on an incorrect starting point. One way that a manager can help determine the true problem in a situation is by identifying the problem separately from its symptoms.

# ABSORPTION COSTING



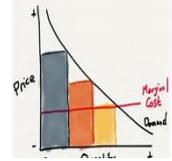
- **Absorption costing or full costing** is a costing system which treats all costs of production as product costs, regardless whether they are variable or fixed. The cost of a unit of product under absorption costing method consists of direct materials, direct labor and both variable and fixed overhead. Absorption costing allocates a portion of fixed manufacturing overhead cost to each unit of product, along with the variable manufacturing cost. Because absorption costing includes all costs of production as product costs, it is frequently referred to as full costing method.

# MARGINAL OR VARIABLE COSTING



- **Variable costing** is a costing system under which those costs of production that vary with output are treated as product costs. This would usually include direct materials, direct labor and variable portion of manufacturing overhead. Fixed manufacturing cost is not treated as a product costs under variable costing. Rather, fixed manufacturing cost is treated as a period cost and, like selling and administrative expenses, it is charged off in its entirety against revenue each period. Consequently the cost of a unit of product in inventory or cost of goods sold under this method does not contain any fixed overhead cost.

# MARGINAL OR VARIABLE COSTING



- **Variable costing** is some time referred to as direct costing or marginal costing. To complete this summary comparison of absorption and variable costing, we need to consider briefly the handling of selling and administrative expenses. These expenses are never treated as product costs, regardless of the costing method in use. Thus under either absorption or variable costing, both variable and fixed selling and administrative expenses are always treated as period costs and deducted from revenues as incurred.

# Similarities and Differences

## Absorption Costing

## Variable Costing

Direct materials  
Direct labor  
Variable manufacturing overhead  
Fixed manufacturing overhead

} Product costs

Selling and administrative

} Period costs

Direct materials  
Direct labor  
Variable manufacturing overhead

} Product costs

Fixed manufacturing overhead  
Selling and administrative

} Period costs

# RELATIONSHIP TO PRICING POLICY



- Here the cost per unit is determined (either total absorption cost, marginal cost or relevant costs) and a set amount, or a set percentage, is added to that to give the selling price. If the forecast volume is sold at the price set, then the forecast profit would be made. However, although useful as a guideline, the method is not sufficient because it is entirely inward looking and pays no heed to competitors or customers.

# RELATIONSHIP TO PRICING POLICY



- The resulting prices must always be looked at with some scepticism, and the organisation must assess how those fit in with the market. An inability to make a reasonable margin on sales must indicate that either costs are too high or demand for the product is too weak.

# INFLUENCES ON PRICING STRATEGY



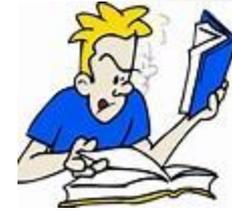
- This involves setting a price by adding a **fixed amount or percentage to the cost** of making or buying the product. In some ways this is quite an old-fashioned and somewhat discredited pricing strategy, although it is still widely used.
- After all, **customers are not too bothered what it cost to make the product** – they are interested in what **value** the product provides them.

# INFLUENCES ON PRICING STRATEGY



- **Cost-plus (or “mark-up”) pricing** is widely used in retailing, where the retailer wants to know with some certainty what the gross profit margin of each sale will be. An advantage of this approach is that the business will know that its costs are being covered. The main disadvantage is that cost-plus pricing may lead to products that are priced un-competitively.

# REVISION QUESTION



Jaguar Industrial Limited makes and sells one product, which has the following standard variable production costs per unit.

	\$
Direct materials cost (2 kg at \$25 per kg)	50
Direct labour cost (3 hours at \$40 per hour)	120
Variable production overhead costs (\$10 per labour hour)	30

The budgeted selling price per unit is \$400 for the coming two years. The production and sales budgets for the next two years are as follows:

	2010	2011
Production in units	50,000	60,000
Sales in units	40,000	70,000

There is no opening inventory at the beginning of 2010. Budgeted fixed production overhead costs are \$20 per unit, and they are absorbed based on a normal production level of 54,000 units per annum. The budgeted non-production costs for the next two years are as follows:

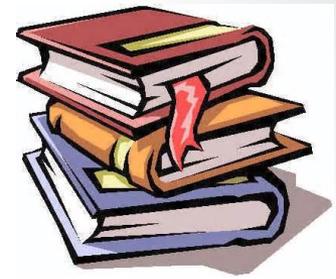
Variable non-production overhead costs \$10 per unit sold  
Fixed non-production overhead costs per annum \$2,000,000

## ***Required:***

***Prepare the budgeted operating statements for each of the coming two years, in a columnar format using absorption and marginal costing systems separately.***

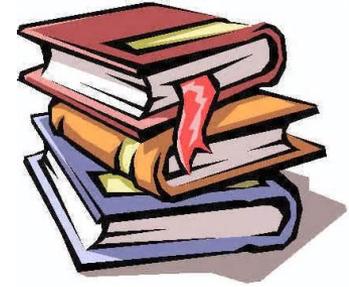
- Source: ***Relevant to AAT Examination Paper 3: Management Accounting***

# BIBLIOGRAPHY



- Cliffsnotes.com, (2015). The Decision-Making Process. [online] Available at: <http://www.cliffsnotes.com/more-subjects/principles-of-management/decision-making-and-problem-solving/the-decisionmaking-process> [Accessed 2 Apr. 2015].
- Anon, (2015). [online] Available at: [http://www2.sunysuffolk.edu/.../Absorption\\_vs\\_Variable\\_Costing](http://www2.sunysuffolk.edu/.../Absorption_vs_Variable_Costing). [Accessed 2 Apr. 2015]
- Anon, (2015). [online] Available at: <http://ManagerialAccounting>, v. 1.0 by Kurt Heisinger and Joe Hoyle [Accessed 2 Apr. 2015]..

# BIBLIOGRAPHY



- Tutor2u.net, (2015). *Pricing - key influences on pricing*. [online] Available at: [http://tutor2u.net/business/marketing/pricing\\_influences.asp](http://tutor2u.net/business/marketing/pricing_influences.asp) [Accessed 9 Apr. 2015]
- Anon, (2015). [online] Available at: [http://www.accaglobal.com/content/dam/acca/global/pdf/sa\\_feb11\\_P3\\_strategy\\_pricing.pdf](http://www.accaglobal.com/content/dam/acca/global/pdf/sa_feb11_P3_strategy_pricing.pdf) [Accessed 9 Apr. 2015].
- Anon, (2015). [online] Available at: <http://www.hkiaat.org/images/uploads/articles/AAT%20P3%20Absorption%20costing.pdf> [Accessed 9 Apr. 2015]. .