

# MANUFACTURING ACCOUNTS

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Some businesses may manufacture their own products instead of trading in finished goods. A manufacturing business is the most complete form of a business because it buys raw materials, converts them into finished items and then sells these items to its customers. Businesses that make their own products must prepare a manufacturing account as part of their internal financial statements. A manufacturing account shows the cost of running and maintaining the factory. It is prepared to calculate the cost of goods produced during the year and it is also known as the production account. Cost of production includes direct cost and indirect cost.

**Direct costs** are expenditure which can be economically identified with a specific cost unit. It has a direct relationship with number of output (units produced). For example:

- Direct materials.
- Direct labour/ direct wages/ factory direct wages/ factory direct labour/ manufacturing wages.
- Direct expenses (example: royalties)

**The total of the direct cost is termed as prime cost.**

**Indirect costs** are factory expenses that are not directly related with the final product. It is commonly termed as factory overheads and is incurred in running the operation of the factory. Indirect cost does not vary with the level of output. Whatever be the level of production, indirect cost remains the same.

**Example of factory overheads:**

- Factory rent and rates
- Factory machinery's depreciation
- Factory insurance
- Factory supervisor's salary
- Indirect materials
- Indirect labour
- Indirect wages
- Factory light and heat
- Depreciation of Factory NCA

**Items not included in the manufacturing account but treated as an expense in the income statement:**

- Office rent and rates
- Office insurance
- Sales staff wages
- Carriage outwards
- Discount allowed
- Depreciation of office non-current assets
- Administrative, selling and distribution cost
- Finance cost
- General expenses, sundry expenses, advertising cost
- Bad debts and provision for doubtful debts

## Inventories in Manufacturing Businesses

Type of inventory	Opening inventory	Closing inventory
Raw Materials	Manufacturing	Manufacturing Statement of financial position
Work in progress	Manufacturing Account	Manufacturing Account Statement of financial position
Finished goods	Income statement	Income statement Statement of financial position

# Manufacturing Account

Stock of opening raw materials		xxx	To arrive at direct material.
Add: Purchases		xxx	
Carriage Inwards		xxx	
		xxx	
Less: Stock of closing raw materials		(xxx)	You add factory overhead!
Direct Material		xxx	
Direct Wages		xxx	
Direct Expenses		xxx	Any costs that only concern with expenses incurred during the production process.
Prime Cost		xxx	
<b>Factory Overhead</b>			
Add Electricity	xxx		
Rent	xxx		
Depreciation of Factory	xxx		
Depreciation of Machinery	xxx		
Depreciation of Loose Tools	xxx		
Repairs related to Production	xxx		
Insurance	xxx		
Indirect Wages	xxx	xxx	
		xxx	
Add Opening work in progress		xxx	
Less Closing work in progress		(xxx)	
Production cost		xxx	

## Manufacturing Account

### EXAMPLE: FULL SET OF FINANCIAL STATEMENT

J. Jarvis Trail balance as at 31 December 2010

	Dr	Cr
Inventory of raw material 1.1.2010	21,000	
Inventory of finished goods 1.1.2010	38,900	
Work-in-progress 1.1.2010	13,500	
Wages (direct 180,000; indirect 145,000)	325,000	
Royalties	7,000	
Carriage inwards (on raw materials)	3,500	
Purchases of raw materials	370,000	
Productive machinery (cost 280,000)	230,000	
Administration computers (cost 20,000)	12,000	
General factory expenses	31,000	
Lighting	7,500	
Factory power	13,700	
Administration salaries	44,000	
Sales reps' salaries	30,000	
Commission on sales	11,500	
Rent	12,000	
Insurance	4,200	
General administration expenses	13,400	
Bank charges	2,300	
Discounts allowed	4,800	
Carriage outwards	5,900	
Sales		1,000,000
Accounts receivable and accounts payable	142,300	64,000
Bank	16,800	
Cash	1,500	
Drawings	60,000	
Capital as at 1.1.2010		357,800
	<u>1,421,800</u>	<u>1,421,800</u>

Note at 31.12.2010:

1. Inventory of raw material 24,000; inventory of finished goods 40,000; work-in-progress 15,000.
2. Lighting, rent and insurance are to be apportioned: factory 5/6, administration 1/6.
3. Depreciation on productive machinery and administration computers at 10 per cent per annum on cost.