ACCY223 Test 1

**Report to the Managing Partner of Konan Moulders Limited (Konan) on the proposed revised job costing and pricing system.**

**Executive Summary**

**-The new costing and pricing system reduces the price of flexible molds however they increase the price of rigid molds as observed below:**

|  |  |  |
| --- | --- | --- |
|  | Flexible mold $ | Rigid Mold $ |
| Price under new costing and pricing method | 590.40 | 684.80 |
| Price under old costing and pricing method | 651.75 | 627.00 |
| Increase/(decrease) required | (61.35) | 57.8 |
|  |  |  |

-The price of flexible molds are $61.35 lower for flexible molds and $57.8 higher than rigid molds.

-This new price is calculated by allocating and apportioning overhead cost to three departments: cutting, machining and finishing.

-The absorption rate of the departments can be observed below:

|  |  |  |  |
| --- | --- | --- | --- |
| $ | Cutting | Machining | Finishing |
| Total overhead | 55500 | 131250 | 90000 |
| Absorption base | 7500 | 12500 | 18000 |
| OAR | 7.4 | 10.5 | 5 |

-The new system would mean that Kohan will likely sell more flexi molds but less rigid mold

-It is recommended that Kohan adopts the new system as it will provide kohan with a more competitive pricing for flexi molds and a greater amount of certainty and control with cost and price management

**Report**

**Overhead allocation/apportioned and Justification**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Cutting | Machining | Finishing | Total | Rate | Apportion Base |
| Consumables | 3000 | 7750 | 3750 | 14500 |  |  |
| Depreciation | 7500 | 17500 | 3750 | 28750 | 10% x | Plant cost |
| Maintenance | 13500 | 27000 | 4500 | 45000 | 18 | Repair hours |
| Establishment Cost | 24000 | 64000 | 48000 | 136000 | 16 | Floor area |
| Factory Management | 7500 | 15000 | 30000 | 52500 | 1500 | Number of employees |
| Total Overhead | 55500 | 131250 | 90000 | 276750 |  |  |

*Justification for the apportionment bases used.*

**Maintenance costs**

Maintenance cost is most likely related to the number of hours of repairs a department requires (e.g Repairing and maintaining machinery in the cutting machining and finishing department). Hence we have apportion the maintenance cost between the hours of repairs used by each department as this reflects the about of maintenance cost each department incurs during operations.

**Establishment costs**

The establishment costs include factory rent and building insurance this cost for each department is dependent on the amount of space used by each department. Hence we have apportioned the establishment cost between the floor area used by each department as this reflects the amount of rent/insurance used by each department

**Factory management cost**

Factory management cost relates to the overall supervision of all factory labour and production processes this cost for each department is dependent on how many employees are used by each department as this reflect how much supervision is required in each department. Hence we have apportioned the Factory management cost based on the number of employees in each department.

**Suitable overhead absorption rate and justification.**

|  |  |  |  |
| --- | --- | --- | --- |
| $ | Cutting | Machining | Finishing |
| Total overhead | 55500 | 131250 | 90000 |
| Absorption base | 7500 | 12500 | 18000 |
| OAR | 7.4 | 10.5 | 5 |

*Justification for absorption base*

Machine hours were applied as the absorption base for Cutting and Machining this is because these departments are more machine than labour intensive – with most of its major cost reflecting machinery e.g maintenance

Labour hours were applied as the absorption base for Finishing as this department is labour intensive with a majority of cost being reflected in labour e.g supervision

**Full cost and desired price**

|  |  |  |
| --- | --- | --- |
|  | Flexible Mold | Rigid Mold |
| Direct Materials | 75 | 80 |
| Direct labour | 320 | 300 |
| Prime cost | 395 | 380 |
| Overhead |  |  |
| Cutting | 29.6 | 59.2 |
| Machining | 42 | 105 |
| Finishing | 50 | 55 |
| Full production cost | 516.6 | 599.2 |
| Profit required 12.5% | 73.8 | 85.6 |
| **Desired Selling Price** | 590.4 | 684.8 |

**Comparison of the desired job prices for Flexible Mould Job and Rigid Mould Job calculated under the old and suggested new costing methods.**

|  |  |  |
| --- | --- | --- |
|  | Flexible mold $ | Rigid Mold $ |
| Price under new costing and pricing method | 590.40 | 684.80 |
| Price under old costing and pricing method | 651.75 | 627.00 |
| Increase/(decrease) required | (61.35) | 57.8 |
|  |  |  |

The new costing and pricing system proposed by Jenny leads to a $61.35 decrease in the price of flexible molds from the old costing and pricing system however it increases the price of the rigid mold by $57.8 from the old system.

This suggest that the old method may have overpriced flexible molds but underpriced rigid molds.

Under the current economic position of Konan this would mean using the new pricing and costing system, flexible molds may be more appealing on the market however rigid mold would become less appealing due to its higher price.

**Implications and Recommendation**

There are advantages and disadvantages to the new costing and pricing system. In this economic state the lower price of flexi molds would allow Kohan to have more competitive pricing and potentially gain a larger share of the market however the higher price of rigid molds means that Kohan would likely sell a lower quantity of these mold and hence lose share in this part of the market.

The new cost and pricing method is more reflective of the cost incurred in production by Kohan however which may be valuable in this time of uncertainty as the 65% mark-up of the old costing and pricing model is unpredictable and may result in Kohan not recovering the cost it incurs in the production process.

Regardless of the greater cost of rigid molds it is recommended that Kohan adopts the new costing and pricing system as it makes its flexible molds more competitive additionally it provides Kohan with the ability to set suitable prices and manage its cost more effectively.