

CHAPTER 7: Variable Costing & Absorption Costing

PART A: STRUCTURED QUESTIONS

1. Explain the main differences between absorption costing and variable costing system.

PART B: PRACTICAL QUESTIONS

1. Mines Company has the following monthly cost structure:

| | Unit variable costs (RM) |
|------------------------|--------------------------|
| Direct labor | 28.50 |
| Direct materials | 85.75 |
| Manufacturing overhead | 15.25 |
| Marketing costs | 5.40 |
| Administrative costs | 5.40 |

Total fixed costs involved every month are:

| | |
|------------------------|-----------|
| Manufacturing overhead | RM130,000 |
| Marketing costs | RM60,000 |
| Administrative costs | RM85,000 |

Assuming the company produced and sold 10,000 units at RM211 per unit and there was no opening inventory on 1 January.

You are required to prepare income statement for the month of January based on marginal and absorption costing.

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2. Always Fat Company has two products with the following unit costs for a period:

| | Product Slim (RM) | Product Thin (RM) |
|-----------------------------|-------------------|-------------------|
| Direct materials | 1.20 | 2.30 |
| Direct labor | 1.80 | 1.50 |
| Variable production OH | 1.00 | 1.20 |
| Fixed production OH | 1.00 | 1.00 |
| Variable selling & admin OH | 0.50 | 0.40 |
| Fixed selling & admin OH | 0.50 | 0.50 |

Production and sales of these two products for the period were:

| | <u>Product Slim (Units)</u> | <u>Product Thin (Units)</u> |
|------------|-----------------------------|-----------------------------|
| Production | 250,000 | 100,000 |
| Sales | 230,000 | 110,000 |

Unit costs in opening stock were the same as those for the period listed above. The selling prices of Product Slim and Product Thin are RM7 and RM8 respectively.

Prepare operating statement by using variable costing and full costing (without over/ under absorption section).

3. The following data were taken from the records of a company:

| | Period 1 (kg) | Period 2 (kg) | Period 3 (kg) |
|---------------|---------------|---------------|---------------|
| Production | 30,000 | 38,000 | 27,000 |
| Sales | 30,000 | 27,000 | 38,000 |
| Opening stock | Nil | Nil | 11,000 |
| Closing stock | Nil | 11,000 | Nil |

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The firm makes a single product (selling price £9 per kg) which the financial details are as follows (based on a normal activity level of 30,000 kg):

| | Costs per kg (£) |
|--------------------------------------|------------------|
| Direct material | 1.50 |
| Direct labor | 1.00 |
| Production overheads (300% of labor) | 3.00 |
| | 5.50 |

Administrative overheads are fixed at £25,000 and one third of the production overheads are fixed.

Prepare separate income statements on variable costing and absorption costing (showing over/under absorption) principles.