onverting/translating from absorption costing to marginal costing – using the eight step process

Seminar example

Product with

a variable cost of £4.00
Factory fixed costs of £12,000
Other overheads of £2,000
We sell 3 000 units
We made 3,500 units
We budgeted to make 4,000 units

Selling price of £30

Q/. Produce marginal and absorption costing accounts.

Why is there a difference?

8 step process answes

1)

	M	A
V	4	4
F	—	3
	4	7

$\frac{£12\,000}{4\,000}$ $\frac{\text{budgeted fixed costs}}{\text{budgeted production}}$

2) Stock movement

o/s doesn't matter
production 3 500
sales 3 000
c/s up by 500

stock goes up by 500 ∴ absorption costing profit higher

3) Abs costing profit ~~is~~ higher by 500 × £3 = £1,500
being the fixed costs absorbed 'hidden' in the cupboard.

4) Marginal costing profit

Sales 3 000 × £30 =	£90 000
Cost of Sales 3000 × £4 =	£12 000
Gross Profit	£78 000
Fixed costs	£12 000
Other overheads	£2 000
Profit	£64,000

5) Absorption profit = £64, 000 + £1,500 = £65,500

6) Calculate ~~Abs~~ costing profit

Sales 3000 × £30 =	90,000
CoS 3000 × 7 =	21 000
	69 000
other oh	2000
	67 000

this not what we expected

7) Why is there a difference?

We need to check over and under absorption
There is nothing to indicate that the actual factory overhead has changed, so it must be to do with the number of units made

the factory overhead

	units			
Budgeted production	4,000	@ £3	=	£12 000
Actual production	3,500	@ £3	=	£10 500
	~~1,500~~ 500			£1 500 under abs.

500 units under what we expected

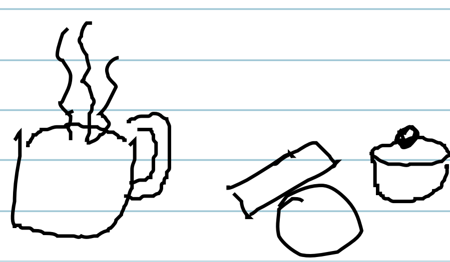
4,000
3,500
= 500 <u>under</u>

we made too few

Absorption costing

S =	£90,000
CoS =	£21,000
	69 000
Oh.	2 000
under abs	1 500
=	65, 500

this is what we expected.



Cup of tea, biscuits <u>and</u> cake!