

## Review Question

Data for comparing absorption costing and marginal costing

						£
						20
						9
						500
	<i>Month 1</i>	<i>Month 2</i>	<i>Month 3</i>	<i>Month 4</i>	<i>Month 5</i>	
	<i>units</i>	<i>units</i>	<i>units</i>	<i>units</i>	<i>units</i>	
Produced	230	270	260	240	250	
Sold	200	210	260	280	300	
Held in stock at end of period	30	90	90	50	nil	

The budgeted level of production 250 units

**Required: Calculate Profits under Absorption Costing.**

**Note: I have provided answer for Absorption Costing; you might try for marginal costing also because as you all know that there is no adjustment of over/under absorption regarding marginal costing profit.**

## Answers of Review Questions

### Absorption costing profit (Month 1 to Month 5)

	<i>Month 1</i>	<i>Month 2</i>	<i>Month 3</i>	<i>Month 4</i>	<i>Month 5</i>	<i>Total</i>
	£	£	£	£	£	£
Sales	<u>4,000</u>	<u>4,200</u>	<u>5,200</u>	<u>5,600</u>	<u>6,000</u>	<u>25,000</u>
<i>Production units</i>	230	270	260	240	250	
	£	£	£	£	£	£
Opening inventory at £11	nil	330	990	990	550	nil
Cost of production:						
At £11 per unit	2,530	2,970	2,860	2,640	2,750	13,750
Under/(over) absorbed	40	(40)	(20)	20	–	
Closing inventory at £11	<u>(330)</u>	<u>(990)</u>	<u>(990)</u>	<u>(550)</u>	<u>nil</u>	<u>nil</u>
Cost of goods sold	2,240	2,270	2,840	3,100	3,300	13,750
Profit	<u>1,760</u>	<u>1,930</u>	<u>2,360</u>	<u>2,500</u>	<u>2,700</u>	<u>11,250</u>

In month 1 the production, at 230 units, is 20 units less than the base level of 250. The cost absorbed by 230 units is £460 which is £40 less than the expected fixed overhead cost of £500 for the month. Another way of arriving at the same conclusion is to say that overhead is under-absorbed by £40 (multiplying 20 units by the fixed overhead cost rate of £2 each). In order to increase the absorbed cost of £460 to the expected (or actual) cost of £500, the £40 difference must be added to production cost in calculating the cost of sales.

In month 2 the production level is 270 units, which is 20 units higher than the base level of 250. This means that fixed overhead is over-absorbed by £40 (20 units at £2). The over-absorbed cost must be deducted from the cost of production to arrive at the cost of goods sold.

In month 3 the production level is 260 units, which is 10 units higher than the base level of 250. This means that fixed overhead is over-absorbed by £20 (10 units at £2). The over-absorbed cost is deducted from the cost of production.

In month 4 the production level is 240 units, which is 10 units less than the base level of 250. This means that fixed overhead is under-absorbed by £20 (10 units at £2). The under-absorbed cost is added to the cost of production.

In month 5 the production level is 250 units, equal to the base level. This means that exactly the correct amount of overhead cost is absorbed and no adjustment is needed.