ACCT 102 – Fundamentals of Accounting II
Chapter 19 – Costing & Performance Reporting

Absorption Costing – All manufacturing costs are included in finished goods and remain there as an asset until the goods are sold. Used for financial reporting to external users and for tax reporting.

Variable Costing – (Direct Costing) – the cost of goods manufactured is composed of only variable manufacturing costs – direct labor, direct materials and variable factory overhead. Fixed factory overhead is treated as a period expense.

Production Costs – Direct Materials, Direct Labor, and Factory Overhead (Variable & Fixed)

Non-Production Costs – Variable Selling & Administrative and Fixed Selling & Administrative

Absorption Costing	Variable Costing
Sales	Sales
Cost of Goods Sold:	Variable Costs
Direct Materials	Direct Materials
Direct Labor	Direct Labor
Variable Factory Overhead	Variable Factory Overhead
Fixed Factory Overhead	Variable S, G & A Expenses
Total COGS	Total Variable Costs
Gross Profit	Contribution Margin
Operating Expenses	Fixed Costs
Fixed S, G & A Expenses	Fixed Factory Overhead
Variable S, G & A Expenses	Fixed S, G & A Expenses
Total S, G & A Expenses	Total Fixed Costs
Net Income	Net Income

Della Lishus Cakes makes and sells wedding cakes. The following information has been gathered from the financial records for the production of 1,000 wedding cakes:

Selling Price: $500 per cake

Direct Materials	$ 120 Per cake
Direct Labor	$ 70 Per cake
Variable OH	$ 60 Per cake
Fixed FOH	$ 100,000 (or $100 per cake)
Variable Selling & Admin Exp.	$ 50 per unit
Fixed Selling & Admin Exp.	$ 50,000 (or $50 per cake)

If we produce and sell 1,000 wedding cakes, what will the income statement look like under traditional (Absorption) Costing and Variable Costing techniques?

If Della Lishus makes and sells 1,000 cakes:

Absorption Costing:

Sales		
Cost of Goods Sold:		
Direct Materials		
Direct Labor		
Variable Factory Overhead		
Fixed Factory Overhead		
Total COGS		
Gross Profit		
Operating Expenses		
Fixed S, G & A Expenses		
Variable S, G & A Expenses		
Total S, G & A Expenses		
Net Income		

Variable Costing:

Sales		
Variable Costs		
Direct Materials		
Direct Labor		
Variable Factory Overhead		
Variable S, G & A Expenses		
Total Variable Costs		
Contribution Margin		
Fixed Costs		
Fixed Factory Overhead		
Fixed S, G & A Expenses		
Total Fixed Costs		
Net Income		

Same facts, except that we make 1,000 but only sell 800

Make 1,000, sell 800:

Absorption Costing:

Sales		
Cost of Goods Sold:		
Direct Materials		
Direct Labor		
Variable Factory Overhead		
Fixed Factory Overhead		
Total COGS		
Gross Profit		
Operating Expenses		
Fixed S, G & A Expenses		
Variable S, G & A Expenses		
Total S, G & A Expenses		
Net Income		

Variable Costing:

Sales		
Variable Costs		
Direct Materials		
Direct Labor		
Variable Factory Overhead		
Variable S, G & A Expenses		
Total Variable Costs		
Contribution Margin		
Fixed Costs		
Fixed Factory Overhead		
Fixed S, G & A Expenses		
Total Fixed Costs		
Net Income		

If we make 1,000 and only sell 800, there will be 200 wedding cakes in inventory. The difference in net income can be calculated by taking the ending inventory of 200 times the fixed overhead cost of $100 per unit – or $20,000. If we make more than we sell, the difference in Net Income will always be equal to the Fixed FOH that is expensed in Variable Costing but in Ending Inventory under Absorption Costing.