

Absorption vs. Variable Costing

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Absorption vs. Variable Costing

- Absorption costing on the income statement is the same presentation as you learned in financial accounting.
- With absorption costing fixed costs are retained on the balance sheet as inventoriable costs.
- Variable costing puts all fixed costs, FOH / MOH on the income statement regardless of sales timing.

Absorption vs. Variable Costing

- With this there will be a difference in income and balance sheet accounts.
- This difference is the fixed overhead which is capitalized, put on the balance sheet, in absorption costing and expensed, put on the income statement, in variable costing.

Absorption vs. Variable Costing

- This is the setup information for the first portion of this presentation.
- Most of the steps will show detail of quantities and values to clarify the values.

Sales price:	\$75
Variable cost per unit of goods sold:	\$35
Fixed cost per unit of goods sold:	\$15
Variable operating costs:	\$60,000
Fixed operating costs:	\$225,000

Quantity sold:	30,000
Quantity of goods manufactured:	30,000
Sales revenues:	\$2,250,000
Variable cost of goods sold:	\$1,050,000
Fixed cost of goods manufactured:	\$450,000

Absorption vs. Variable Costing

- The absorption concept income statement, the same format from financial accounting looks like this.
- The unit value of cost of goods sold is the sum of unit variable and unit fixed costs.

Sales equal quantity of goods produced	
Miramar Merchandisers Inc.	
Income Statement (Absorption)	
For the Month Ended January 31, 2015	
Sales revenues ($\$75 \times 30,000$ units)	\$2,250,000
Less: Cost of goods sold [$(\$35 + \$15) \times 30,000$ units]	1,500,000
Gross profit	750,000
Less: Operating expenses ($\$60,000 + \$225,000$)	285,000
Operating income (loss)	\$465,000

Absorption vs. Variable Costing

- The variable costing concept lists variable costs associated with sales then lists the fixed costs associated with production and operations.
- Since quantities produced is the same as quantity sold there is no difference between absorption and variable costing.

Sales equal quantity of goods produced	
Miramar Merchandisers Inc.	
Income Statement (Variable)	
For the Month Ended January 31, 2015	
Sales revenues ($\$75 \times 30,000$ units)	\$2,250,000
Less variable expenses	
Variable cost of goods sold ($\$35 \times 30,000$ units)	1,050,000
Variable operating expenses ($\$60,000$)	60,000
Contribution margin	1,140,000
Less fixed expenses	
Fixed FOH / MOH ($\$15 \times 30,000$ units)	450,000
Fixed operating expenses	225,000
Operating income (loss)	\$465,000

Absorption vs. Variable Costing

- The balance sheets contain the same values.

Balance sheet assets:	
Finished goods beginning inventory:	\$1,000,000
Goods manufactured:	3,000,000
Goods available for sale:	4,000,000
Cost of goods sold ($\$50 \times 30,000$)	1,500,000
Finished goods ending inventory:	\$2,500,000

Balance sheet assets:	
Finished goods beginning inventory:	\$1,000,000
Goods manufactured:	3,000,000
Goods available for sale:	4,000,000
Cost of goods sold ($\$50 \times 30,000$)	1,500,000
Finished goods ending inventory:	\$2,500,000

Difference in income:	\$0
Difference in balance sheet inventory:	0
Total financial statement difference:	\$0

Absorption vs. Variable Costing

- The setup information is changed to 35,000 manufactured and only 30,000 sold.
- This will present a difference in income and the assets on the balance sheet.

Sales price:	\$75
Variable cost per unit of goods sold:	\$35
Fixed cost per unit of goods sold:	\$15
Variable operating costs:	\$60,000
Fixed operating costs:	\$225,000

Quantity sold:	30,000
Quantity of goods manufactured:	35,000
Sales revenues:	\$2,250,000
Variable cost of goods sold:	\$1,050,000
Fixed cost of goods manufactured:	\$525,000

Absorption vs. Variable Costing

- This is the income statement for the absorption costing concept, the same as what was learned in financial accounting.

Sales equal quantity of goods produced	
Miramar Merchandisers Inc.	
Income Statement (Absorption)	
For the Month Ended January 31, 2015	
Sales revenues ($\$75 \times 30,000$ units)	\$2,250,000
Less: Cost of goods sold [$(\$35 + \$15) \times 30,000$ units]	1,500,000
Gross profit	750,000
Less: Operating expenses ($\$60,000 + \$225,000$)	285,000
Operating income (loss)	\$465,000

Absorption vs. Variable Costing

- With the variable costing income statement, we see the differences.
- While the variable and fixed costs of units sold are on the income statement, so is the fixed overhead of units not sold, $\$15 \times 35,000$ units rather than 30,000 units.

Sales equal quantity of goods produced	
Miramar Merchandisers Inc.	
Income Statement (Variable)	
For the Month Ended January 31, 2015	
Sales revenues ($\$75 \times 30,000$ units)	\$2,250,000
Less variable expenses	
Variable cost of goods sold ($\$35 \times 30,000$ units)	1,050,000
Variable operating expenses ($\$60,000$)	60,000
Contribution margin	1,140,000
Less fixed expenses	
Fixed FOH / MOH ($\$15 \times 35,000$ units)	525,000
Fixed operating expenses ($\$225,000$)	225,000
Operating income (loss)	\$390,000

Absorption vs. Variable Costing

- The difference between absorption and variable becomes apparent at this level.
- The absorption operating income is \$465,000 and the variable operating income is \$390,000.
- The difference is \$75,000.
- That difference is also $\$15$ in fixed manufacturing overhead \times (35,000 units manufactured - 30,000 units sold), \$75,000.

Absorption vs. Variable Costing

- In the balance sheet you can see the difference of \$75,000 in cost of goods sold and ending balance.
- This offsets the \$75,000 difference on the income statement.

Balance sheet assets:	
Finished goods beginning inventory:	\$1,000,000
Goods manufactured:	3,000,000
Goods available for sale:	4,000,000
Cost of goods sold (\$50 × 30,000)	1,500,000
Finished goods ending inventory:	\$2,500,000

Balance sheet assets:	
Finished goods beginning inventory:	\$1,000,000
Goods manufactured:	3,000,000
Goods available for sale:	4,000,000
Cost of goods sold [(\$35 × 30,000) + \$525,000]	1,575,000
Finished goods ending inventory:	\$2,425,000

Difference in income:	\$75,000
Difference in balance sheet inventory:	75,000
Total financial statement difference:	\$0

Absorption vs. Variable Costing

- The difference between absorption and variable costing financials is the capitalizing fixed manufacturing overhead in absorption and expensing it in variable costing.
- Variable costing is not permitted in public reporting of financials.

Absorption vs. Variable Costing

The end.