

**PRINCIPLES OF FINANCIAL AND MANAGERIAL ACCOUNTING II**

**Cost and Revenue Relationships for Management**

- I. Absorption Costing and Variable Costing
  - A. Chapter 22, pp. 956-965; 976-983
  - B. New format for \_\_\_\_\_
  - C. Excellent decision tool
  
- II. Differential Analysis
  - A. Chapter 26, pp. 1134-1136; 1140-1141
  - B. No preferred format
  - C. Emphasizes making \_\_\_\_\_ decision for \_\_\_\_\_ reasons

Comparison of Costing Methods

Absorption

Variable

1. ALL costs “_____” by the product: DM, DL, and MO become part of finished good.
2. _____ and <i>variable</i> manufacturing costs are included in COGS:  $\begin{array}{r} S \\ - \text{COGS} \\ = \text{GP} \end{array}$
3. F MO is a _____ cost.
4. By placing F MO in product, some _____ are taken to next period in _____.
5. When inventory _____ net income is _____.
6. For _____ purposes.  Only acceptable method for financial reporting or tax purposes.
7. Better for _____ decisions (need to cover _____ costs in long-run).

1. DM, DL, and V MO become part of the cost of the finished good.
2. Only _____ manufacturing costs are included in COGS:  $\begin{array}{r} S \\ - \text{_____} \\ = \text{MM} \\ - \text{VE} \\ = \end{array}$
3. F MO is a _____ cost.
4. F MO is _____ with time period and never taken to next period in _____.
5. When inventory _____ net income is _____.
6. For _____ purposes.  Not acceptable for financial reporting or tax purposes.
7. Better for _____ decision making (concerned with covering _____ costs).

### Comparison of Absorption Costing and Variable Costing

The Rainey Company began operations in January of the current year. During the first year of operations the company manufactured 50,000 units, of which 44,000 were sold at \$40 per unit. Variable manufacturing costs were \$12 per unit, and fixed manufacturing overhead was \$260,000. Variable selling and administrative expenses were \$4.50 per unit sold, and fixed selling and administrative expenses were \$150,000. Instructions: (1) Prepare an absorption costing income statement, and (2) prepare a variable costing income statement in good form. (3) Calculate and explain the difference, if any, in the two net income amounts.

RAINEY COMPANY	
Income Statement -- ABSORPTION Costing	
For the Year Ended December 31, xxxx	
SALES (_____ units x \$_____)	\$ _____
Cost of Goods Sold:	
Variable Cost of Goods	
Manufactured (_____ x \$_____)	\$ _____
Fixed Manufacturing Overhead	<u>260,000</u>
Cost of Goods Manufactured	\$ _____
Less: Ending Inventory	
(_____ units x \$_____)	_____
<b>COST OF GOODS SOLD</b>	<u>_____</u>
GROSS PROFIT	\$ _____
Selling and Administrative Expenses:	
Variable (\$_____ x _____ units)	\$ _____
Fixed	<u>150,000</u>
<b>INCOME FROM OPERATIONS</b>	<u>\$ _____</u>

RAINEY COMPANY	
Income Statement -- VARIABLE Costing	
For the Year Ended December 31, xxxx	
SALES (_____ units x \$_____)	\$ _____
<i>Variable</i> Cost of Goods Sold:	
Variable Cost of Goods	
Manufactured (_____ x \$_____)	\$ _____
Less: Ending Inventory	
(_____ units x \$_____)	_____
<b>VARIABLE COST OF GOODS SOLD</b>	<u>_____</u>
	\$ _____
Variable Selling and Administrative Expenses	_____
	\$ _____
Fixed Costs and Expenses:	
Manufacturing Overhead	\$ 260,000
Selling and Administrative	<u>150,000</u>
	<u>410,000</u>
<b>INCOME FROM OPERATIONS</b>	<u>\$ _____</u>

**Note: This example is for instructional purposes only; for homework follow the examples in the textbook.**

Cost and Revenue Relationships for Management (cont'd)

(3) Calculate and explain the difference in the two net income amounts.

Net Income – Absorption \$ \_\_\_\_\_

Net Income – Variable \_\_\_\_\_

Difference \_\_\_\_\_

Explanation

In total:

Change in Ending Inventory – Absorption (EI - BI) \$ \_\_\_\_\_

Change in Ending Inventory – Variable (EI - BI) \_\_\_\_\_

Difference \_\_\_\_\_

Per Unit:

Ending Inventory – Absorption \$ \_\_\_\_\_

Ending Inventory – Variable \_\_\_\_\_

Difference per Unit \_\_\_\_\_

x Change in Number of Units in Inventory (EI - BI) \_\_\_\_\_

Difference \_\_\_\_\_

What is the \_\_\_\_\_ ?

\_\_\_\_\_ =