

Questions and Answers

Briefly explain what is meant by marginal (variable) costing:

- A costing system in which all variable (but no fixed) manufacturing costs are included when determining the cost of production

Briefly explain what is meant by full (absorption) costing:

- A method of costing in which all variable and all fixed manufacturing costs are included when determining the cost of production

Briefly explain why the operating profits resulting from the use of the two costing methods will usually differ:

- Under an absorption costing system, both opening and closing stock include an *element* of fixed manufacturing costs
- The difference between the operating profit under a marginal costing system and that under absorption costing simply reflects the change in this *element* over the period

Under what circumstances will the operating profit under marginal (variable) costing be identical to that under full (absorption) costing:

- The two profits will be identical if this change is zero – this will happen if production = sales
- And there is no change in the fixed overhead absorption rate

Profit Reconciliation Example:

Profit reconciliation		2014	2015
Profit per marginal costing		£ 245,000.00	£ 339,000.00
Add fixed OH in closing stock		£ 30,000.00	£ -
Less fixed OH in opening stock		£ -	£ 30,000.00
Profit per absorption costing		£ 275,000.00	£ 309,000.00