Exercise 2.3 ABSORPTION AND MARGINAL COSTING

Northwood Corporation is considering changing its method of inventory valuation from absorption costing to variable costing and engaged you to determine the effect of the proposed change on the 2017 financial statements.

The corporation manufactures a Gink which is sold for M20 per unit. Production capacity is budgeted at 100 000 units of Gink annually. At this level of production, the cost per unit are:

|  |  |
| --- | --- |
| Material | M3.00 |
| Labour | M5.00 |
| Variable manufacturing overhead | M1.00 |
| Fixed manufacturing overhead | M1.00 |

**Selling expenses at 100,000 unit level**

|  |  |
| --- | --- |
| Variable | M1.00 |
| Fixed(advertising) | M0.50 |

|  |  |
| --- | --- |
| Opening Stock 1st April 2016 | 5000 units |
| Production in current year | 80 000 units |
| Sales | 60 000 units |

You are required to:

1. Prepare an income statement on the absorption cost basis
2. Prepare an income statement on a variable cost basis with a prior year adjustment for the change in stock valuation.