

## LECTURE 5 & 6

### MARGINAL COSTING AND DECISION –MAKING

- ✓ **Definition of marginal costing:**  
 “The accounting system in which **variable costs** are charged to cost units and fixed costs of the period are written off in full against the aggregate **contribution**. Its special value is in recognizing cost behaviour, and hence assisting in decision making.”
- ✓ **Definition of variable cost:** “The part of the cost of one unit of product or service which would be avoided if that unit was not produced, or which would increase if one extra unit was produced.”
- ✓ **Definition of contribution:** “Sales value less variable cost of sales. It may be expressed as total contribution, contribution per unit or as a percentage of sales.”
- ✓ **E.g.: Hoho Limited** makes 2 products, AA and BB in one department. Selling prices are RM110 per unit of AA and RM160 per unit of BB. The budgeted production and sales unit for Year 2006 are 2,000 units of AA and 800 units of BB, and there were no stocks of either product at the beginning of Year 2006. Material costs expected to be RM25 and RM40 for a unit of AA and BB respectively. Production hours for one unit are 4 hours and 6 hours for AA and BB respectively. Direct workers are paid RM9.00 per hour, and budgeted overheads for Year 2006 are :

Variable overhead	RM 47,360
Fixed overhead	<u>87,040</u>
	<u>RM134,400</u>

**Required:**

- a) Calculate the budgeted overhead absorption rate per direct labour hour for Year 2006
- b) Calculate the budgeted variable overhead absorption rate per direct labour hour for Year 2006
- c) Prepare a product cost for one unit of AA and one unit of BB to show the variable cost and contribution
- d) Calculate the budgeted total contribution made by each product, and the budgeted profit for the year

**SOLUTION:**

a) Budgeted direct labour hours:		
AA	2,000 units x 4 hours	8,000
BB	800 units x 6 hours	<u>4,800</u>
		<u>12,800</u>

Budgeted overhead:	RM134,400
<b>Overhead per direct labour hour (RM134,400 / 12,800 hours)</b>	<b>RM10.50</b>

b) Budgeted direct labour hours	12,800 hours
Budgeted variable overhead cost	RM47,360
Variable overhead rate per direct labour cost (RM47,360 / 12,800 hours)	RM 3.70

c) Product cost	AA	BB
Material	RM 25	RM 40
Direct labour:		
4 hours x RM9.00	36	
6 hours x RM9.00		54

Variable Overhead:		
4 hours x RM 3.70	14.80	
6 hours x RM 3.70		<u>22.20</u>
Variable cost	RM 75.80	RM116.20
Selling price	<u>110.00</u>	<u>160.00</u>
Contribution	<u>RM 34.20</u>	<u>RM 43.80</u>
d) Total contribution:		
Contribution from AA 2,000 units x RM34.20		RM 68,400
Contribution from BB 800 units x RM43.80		<u>35,040</u>
Total contribution		103,440
(-) Fixed overheads		<u>87,040</u>
Profit		<u>RM 16,400</u>

✓ **E.g.: Bola Company** makes 2 products, EE and YY in one department. The information all relates to budget Year 2008. There are no finished product stocks at the beginning of Year 2008.

Product	EE	YY
	RM / unit	RM / unit
Direct material cost	12.50	15.00
Direct labour at RM8.00 per hour	24.00	12.00
Variable production overhead	6.00	3.00
Selling price	70.00	48.00
	Units	Units
Production	9,000	12,000
Sales	8,500	10,400

Fixed production overhead RM315,000. Fixed administration, selling and distribution overhead, RM 121,000

**Required:**

- Prepare a profit statement for Year 2008 under an absorption costing
- Prepare a profit statement for Year 2008 under marginal costing

**SOLUTION**

a) Absorption Costing		
Budgeted direct labour hours:		
EE 9,000 units x (RM24 / RM8)		27,000
YY 12,000 units x (RM12 / RM8)		<u>18,000</u>
		<u>45,000</u>
Fixed production overhead		RM315,000
Fixed overheads per direct labour hour (RM315,000 / 45,000 hours)		RM 7 per hour
Products cost:	EE	YY
	RM per unit	RM per unit
All variable costs	42.50	30.00
Fixed production overhead absorbed at RM 7 per direct labour hour:		
3 hours x RM 7	21.00	
1.50 hours x RM 7		<u>10.50</u>
Production cost	<u>RM63.50</u>	<u>RM40.50</u>

## Profit Statement in Absorption Costing:

	EE RM	YY RM	Total RM
Sales	<u>595,000</u>	<u>499,200</u>	<u>1,094,200</u>
(-)Production Costs:			
Direct materials	112,500	180,000	292,500
Direct labour	216,000	144,000	360,000
Variable production overhead	54,000	36,000	90,000
Fixed production overhead	<u>189,000</u>	<u>126,000</u>	<u>315,000</u>
Production cost	<u>571,500</u>	<u>486,000</u>	<u>1,057,000</u>
(-) Stock	<u>(31,750)</u>	<u>(64,800)</u>	<u>(96,550)</u>
Production cost of sales	<u>539,750</u>	<u>421,200</u>	<u>960,950</u>
<b>Production profit</b>	<b>55,250</b>	<b>78,000</b>	<b>133,250</b>
(-) Admin cost			<u>121,000</u>
<b>Net profit</b>			<b><u>12,500</u></b>

## b) Profit Statement in Marginal Costing

	EE RM	YY RM	Total RM
Sales	595,000	499,200	1,094,200
(-) Production Cost:			
Direct materials	112,500	180,000	292,500
Direct labour	216,000	144,000	360,000
Variable Production Overhead	<u>54,000</u>	<u>36,000</u>	<u>90,000</u>
Total Variable production Cost	<u>382,500</u>	<u>360,000</u>	<u>742,500</u>
(-) Stock	<u>21,250</u>	<u>48,000</u>	<u>69,250</u>
Variable production cost of sales	<u>361,250</u>	<u>312,000</u>	<u>673,250</u>
Contribution	<u>233,750</u>	<u>187,200</u>	<u>420,950</u>
(-) Fixed overhead:			
Production			315,000
Admin			<u>121,000</u>
			<u>436,000</u>
<b>Net loss</b>			<b><u>(15,050)</u></b>

**Dealing With Opening Stock**

- ☒ Opening stock is the closing stock of the preceding product.
- ☒ Whether it was valued in the preceding period, absorption or marginal, it will be brought forward at that same valuation.
- ☒ **E.g.: Assume Lana Limited** makes a single product. It is sold for RM48 per unit and 12,100 units are budgeted to be sold in year 2008. There were 250 units of the product in stock at 1 January 2008. For year 2008, variable production costs are budgeted as RM22 per unit, and fixed production costs are budgeted as RM180,000 for the budgeted production of 12,000 units. Fixed administration, selling and distribution overheads are budgeted as RM96,000. Costs in Year 2007 can be assumed to be the same as those budgeted for Year 2008.

**Required:**

- a) Prepare budgeted profit statement for Year 2008 using marginal costing and absorption costing

**SOLUTION****Budgeted Profit Statement For Year 2008 Using Marginal Costing**

			RM
Selling price per unit			48.00
Variable cost per unit			<u>22.00</u>
Contribution per unit			<u>26.00</u>
Units to be sold			12,100 units
Total contribution			RM314,600
(-) Fixed Overhead:	Production	180,000	
	Admin	<u>96,000</u>	<u>RM276,000</u>
Profit			<u>RM 38,600</u>

**Budgeted Profit Statement For Year 2008 Using Absorption Costing**

		RM
Variable cost per unit		22.00
Fixed production overhead RM180,000 / 12,000 units		<u>15.00</u>
Full production cost per unit		37.00
Selling price		<u>48.00</u>
Production profit per unit		<u>11.00</u>
Units to be sold		12,100 units
Total production profit		133,100
(-) Admin. , selling & distribution		<u>96,000</u>
Profit		<u>37,100</u>

**SHORT-TERM DECISION MAKING**

- ✓ Making decision for the benefits of the organisation is the most crucial task of a manager in an organisation, especially in a business firm.
- ✓ One of the pre-requisite of making a good decision is to be able to evaluate thoroughly each course of action before deciding to choose one of them to be implemented.
- ✓ Short-term decision making is involved in deciding on matters that have a shorter financial implication.
- ✓ Short-term decisions are made frequently and the implementation of the decision usually takes a shorter period.
- ✓ Decision making process:
  1. Define objectives or problems
  2. Identify alternative courses of actions
  3. Evaluate the alternative courses of actions identified
  4. Select the best alternative
  5. Implement the alternative selected and control
- ✓ The relevant costs and relevant revenues that is required for decision-making process is only those that will be affected by the decision.
- ✓ Opportunity cost also need to be included in evaluation of courses of actions in decision making.
- ✓ **Opportunity cost is cost to measure the opportunity or benefit that is foregone or sacrificed when the choice of one course of action requires that an alternative be given up.** Example of

- opportunity cost is the sales revenue foregone from the sales of a product when the company decided to sell another product line.
- ✓ Opportunity cost considered relevant cost because it can influence the decision that is going to be made.
  
- ✓ Types of short term decision making:
  1. Make or buy decision
  2. Special order
  3. Add or delete
  4. Decision-making under limiting factors

**Make Or Buy Decision**

- ☒ Also known as outsourcing decision.
- ☒ Managers of a firm are responsible to decide whether or not it is worthwhile for the firm to manufacture internally the products or components that the firm is going to sell or use in operation, or it is better off for the firm to acquire the goods or components from an external supplier.
- ☒ Firms usually consider making internally when they want to fully utilize the excess capacity and also to gain benefits from diversification of activities.
- ☒ Managers have to choose which alternative will have the lowest relevant costs or the highest relevant revenues.
- ☒ Meaning, the firm should make internally products if the relevant costs of manufacturing the items are lower than the relevant costs of buying them from an external buyer.
- ☒ However, if the relevant costs of buying are cheaper, then the firm should buy the items from the external supplier.
  
- ☒ **E.g.:** Alfa Co. is considering manufacturing 1,000 units of component Y. The components are for use in the production of product SOB. The estimated costs to produce a unit of component Y based on budgeted production of 10,000 units is as follows :

Direct material costs	RM16.00
Direct labour costs	10.00
Variable production overhead	8.00
Fixed production overhead	<u>7.00</u>
Total production costs	<u>RM41.00</u>

BB Co. has been selling a unit of component Y at RM38.00. Advise the management of Alfa whether to manufacture or buy the component.

**SOLUTION**

Determine the relevant cost of manufacturing the components:

Direct material costs	RM16.00
Direct labour costs	10.00
Variable production overhead	<u>8.00</u>
Total relevant manufacturing costs	<u>RM34.00</u>

Compared to the cost of buying from BB Co. which is RM38.00, it is better for Alfa to manufacture the component internally because the firm can save RM4.00 per unit.

- ☒ **E.g.:** Suppose now that Alfa has limited labour force. In order to work on the 1,000 units of component Y, the firm has to forego the production of 100 units of product UEL, which is sold for RM200.00 per unit. The marginal cost associated to the product is RM120.00. Please advise whether Alfa need to manufacture the components or not?

**SOLUTION**

Determine the relevant costs of manufacturing the component:

Direct material costs	RM16.00
Direct labour costs	10.00
Variable production overhead	8.00
Opportunity cost: $\frac{(RM200-120) \times 100 \text{ units UEL}}{1,000 \text{ units Y}}$	<u>8.00</u>
Total relevant manufacturing costs	<u>RM42.00</u>

Compared to the cost of buying from BB Co. which is RM38.00, it is cheaper to buy the component Y from BB Co.

**Special Order**

- ☐ Business is sometimes having to decide whether to furnish special orders or not.
- ☐ Special orders are normally orders to purchase at a large volume but at a relatively lower profit than the normal market price.
- ☐ These special orders may be attractive when the firm is having excess capacity and the customer might someday become the regular customer of the firm. To decide on a special order, the firm has to determine whether the special order can generate some contribution margin or not.
- ☐ If the special order can ensure the firm obtaining extra contribution, then it is advisable for the company to accept the special order.

- ☐ **E.g.: Tsin Fei Limited** is involved in manufacturing and selling of sports shoes branded “HTF” to local distributors. The company has the capacity to produce 18,000 pairs of “HTF” annually. The information extracted from the income statement of the company for the year ended 2006 is as follows:

Selling revenues (16,500 pairs)	RM891,000
(-) Costs:	
Direct materials costs	(363,000)
Direct labour costs	(198,000)
Factory overheads	(176,600)
Selling and administrative overheads	<u>(108,500)</u>
Net profits	<u>RM 44,900</u>

40% of the factory overheads are fixed overheads whereas only 30% of the selling and administrative overheads are variable.

Recently, Tsin Fei Limited received an order from Lee Fang Co. for 1,500 pairs of “HTF”. The price offered was RM45.00 per pair. The sales manager of Tsin Fei is reluctant to accept the order because the price is too low compared to the market price. You are required to advise the management regarding the special order.

**SOLUTION**

Relevant costs of the special order per unit:

Direct material costs	RM22.00
Direct labour costs	12.00
Factory overheads: $(176,600 \times 60\%) / 16,500$	6.42
Selling and administrative overheads: $(108,500 \times 30\%) / 16,500$	<u>1.97</u>
Unit product cost	<u>RM42.39</u>

The relevant revenue of the special order = RM45.00 x 1,500 units = RM67,500

Whereas the relevant costs of production = RM42.39 x 1,500 units = RM63,585

The contribution margin from special order sales (67,500- 63,585) = RM 3,915

Based on the above, it is advisable for Tsin Fei to accept the special order because it will enable the company to get additional profit of RM3,915.

**Add Or Delete**

- ☛ Management of business sometimes has to face a very difficult situation when one or more of the firm’s sub-units such as product lines, departments or segments are continuously making losses.
- ☛ The last thing the company is able to do is probably discontinuing the product line, segments or even the departments
- ☛ Sometimes, the discontinuance decision can make the company performs better but, there are also possibilities that the firm’s profitability will become even worse when the decision is taken
- ☛ The decision rule regarding the discontinuance decision is as follows :
  - a) Discontinue a segment when the benefits of discontinuing is more than the costs
  - b) Proceed with the operation as usual when the discontinuing cost is more than the benefits
  - c) Add a segment when the benefits of adding the segment are more than the costs related to it
  - d) Do not add the segment when the benefits of adding the segment are less than the costs related to it
  
- ☛ **e.g.: Kiki Company** currently operates 3 departments: Bedding, Furniture and Kitchen departments. The income statement of the company for the year ended March 2006 shows the Furniture department is making a loss as follows:

	<b>BEDDING RM'000</b>	<b>FURNITURE RM'000</b>	<b>KITCHEN RM'000</b>
<b>Sales revenue</b>	800	500	600
	<u>600</u>	<u>420</u>	<u>400</u>
(-) : Costs of sales	200	80	200
Gross margin			
(-) : Operating costs:	120	64	80
Head office overhead	30	20	20
Selling overhead	<u>20</u>	<u>27</u>	<u>10</u>
Administrative overhead	<u>30</u>	<u>(31)</u>	<u>90</u>
Net profit / (loss)			

The losses that Furniture department made had lowered down the overall company’s profit to RM89,000. He suggests that the department be closed permanently. The effect of the closure is studied and the following information is available:

- a) All costs of sales are variable and all of the selling overheads in the Furniture department will be eliminated
- b) The sales in Bedding department is expected to increase by 20%. However, Kitchen department sales is expected to reduce by 5%
- c) The other departments will share the head-office overhead of the Furniture department equally
- d) Only RM12,000 of the administrative costs in furniture department can be avoided because the staffs of the department will be transferred to Kitchen department
- e) The company will incur an additional cost to close down department amounting to RM29,000

Should Furniture department be closed down?

**SOLUTION**

	<b>BEDDING RM'000</b>	<b>FURNITURE RM'000</b>	<b>KITCHEN RM'000</b>
Sales revenue	960	0	570
(-) : Cost of sales	<u>720</u>	<u>0</u>	<u>380</u>
Gross margin	240	0	190
(-) : Operating costs :			
Head Office Overhead	152	0	112
Selling Overheads	30	0	20
Administrative overhead	20	0	25
Closure cost :	<u>00</u>	<u>29</u>	<u>00</u>
Net Profit / (Loss)	<u>38</u>	<u>(29)</u>	<u>33</u>

The company's overall profit :	RM
- Before closing down Furniture	89,000
- After closing down Furniture	<u>42,000</u>
Reduction from closing down (RM89,000 –RM 42,000)	<u>47,000</u>

Based on the above, the company should not close down Furniture department because it will result in the company's net profit decreasing by RM47,000.

**Decision Making Under Limiting Factors**

- Making short-term decision and implementing the decision is easier when the company is operating with sufficient resources and capacity.
- But, in reality, most of the time organizations have to operate under the condition of insufficient resources like shortage of labour or raw material to accomplish orders from customers.
- In this situation, the firm has to decide whether or not to furnish the order under that condition, and how to optimize the profitability.
- **E.g.: Red Company** manufactures three types of products in a mass production process, namely, Jico, Kilos and Limo. The unit selling price and the products' cost structures based on the budgeted production and sales units are as follows:

<b>PRODUCTS</b>	<b>JICO RM</b>	<b>KILOS RM</b>	<b>LIMO RM</b>
Material costs	4	6	8
Direct labour costs	10	9	7
Variable production costs	5	6	8
Fixed production costs	2	6	5
Selling price	29	31	30
Budgeted production and sales unit	5000	5000	5000

The companies' direct labour hour and material requirement of each product are shown below:

<b>PRODUCTS:</b>	<b>JICO</b>	<b>KILOS</b>	<b>LIMO</b>
Direct labour (hour)	3	5	1
Material (kg)	2	3	4

Based on a recent market survey, it is expected that the demands for the three products for the coming month are as follows:

- 6000 units of Jico
- 5000 units of Kilos
- 4000 units of Limo

However, due to the market forces, the total direct labour hours available for the coming month are only 38,000 hours. Given the limited labour hours, you are required to advise the manager of the company as to the most profitable production mix of the company.

**SOLUTION****Step 1: Identify The Limiting Factors**

Total direct labour requirement:

<b>PRODUCTS</b>	<b>JICO</b>	<b>KILOS</b>	<b>LIMO</b>
Direct labour per unit :	3	5	1
No. of production and sales unit	6,000	5,000	4,000
Total direct labour hours required	18,000	25,000	4,000

Total direct labour hours required:	47,000
Total direct labour hours available:	38,000
Shortfall in direct labour hours (47,000 – 38,000)	9,000

**Step 2: Determine The Ranking Of The Products According To The Highest Unit**

Contribution margin per limiting factors (direct labour hour):

<b>PRODUCTS</b>	<b>JICO</b>	<b>KILOS</b>	<b>LIMO</b>
Selling price	RM29	RM31	RM30
(-) : Variable cost	<u>RM19</u>	<u>RM21</u>	<u>RM23</u>
Unit Contribution margin	<u>RM10</u>	<u>RM10</u>	<u>RM 7</u>
Direct labour (hour)	3	5	1
Unit contribution per Direct Labour Hour: Unit Contribution Margin / Direct Labour Hour	RM 10 / 3 hours = RM3.33	RM 10 / 5 hours = RM 2.00	RM 7 / 1 hour = RM 7.00
Ranking	2	3	1

**Step 3: Allocate The Scarce Labour Hours To The Product According To The Ranking Above:**

Allocation of available labour hours:	38,000 hours
Produce Limo : 4,000 units x 1 labour hour	4,000 hours
Balance available : To produce Jico :	38,000 hours – 4,000 hours = 34,000
5,000 units x 3 labour hours	15,000 hours
Balance available: To produce Kilos :	34,000 hours – 15,000 hours = 19,000
3,800* units x 5 labour hours	19,000 hours

\* With the available 19,000 labour hours can only produce 3,800 units (19,000 hours / 5 hours)

So, the most profitable production mix is:

- 4,000 units of Limo
- 5,000 units of Jico
- 3,800 units of Kilos

**Calculation of net profit for the company:**

Total contribution:		RM
Limo	4,000 units x RM7.00	28,000
Jico	5,000 units x RM10.00	50,000
Kilos	3,800 units x RM10.00	<u>38,000</u>
Total contribution		116,000

(-) : Fixed cost : 5,000 units x RM13.00 (65,000)  
**Net Profit** **51,000**

**ABSORPTION COSTING PRO-FORMA**

	£	£
Sales Revenue		xxxxx
<u>Less Absorption Cost of Sales</u>		
Opening Stock (Valued @ absorption cost)	xxxx	
Add Production Cost (Valued @ absorption cost)	xxxx	
Total Production Cost	xxxx	
Less Closing Stock (Valued @ absorption cost)	<u>(xxx)</u>	
Absorption Cost of Production	xxxx	
Add Selling, Admin & Distribution Cost	xxxx	
Absorption Cost of Sales		(xxxx)
Un-Adjusted Profit		xxxxx
Fixed Production O/H absorbed	xxxx	
Fixed Production O/H incurred	(xxxx)	
(Under)/Over Absorption		xxxxx
Adjusted Profit		xxxxx

**Reconciliation Statement for Marginal Costing and Absorption Costing Profit**

	\$
Marginal Costing Profit	xx
ADD	
(Closing stock – opening Stock) x OAR	xx
= Absorption Costing Profit	xx

Where OAR( overhead absorption rate) =  $\frac{\text{Budgeted fixed production overhead}}{\text{Budgeted levels of activities}}$

**Marginal Costing versus Absorption Costing**

After knowing the two techniques of marginal costing and absorption costing, we have seen that the net profits are not the same because of the following reasons:

**1. Over and Under Absorbed Overheads**

In absorption costing, fixed overheads can never be absorbed exactly because of difficulty in forecasting costs and volume of output. If these balances of under or over absorbed/recovery are not written off to costing profit and loss account, the actual amount incurred is not shown in it. In marginal costing, however, the actual fixed overhead incurred is wholly charged against contribution and hence, there will be some difference in net profits.

## 2. Difference in Stock Valuation

In marginal costing, work in progress and finished stocks are valued at marginal cost, but in absorption costing, they are valued at total production cost. Hence, profit will differ as different amounts of fixed overheads are considered in two accounts.

The profit difference due to difference in stock valuation is summarized as follows:

- a. When there is no opening and closing stocks, there will be no difference in profit.
- b. When opening and closing stocks are the same, there will be no difference in profit, provided the fixed cost element in opening and closing stocks are of the same amount.
- c. When closing stock is more than opening stock, the profit under absorption costing will be higher as comparatively a greater portion of fixed cost is included in closing stock and carried over to next period.
- d. When closing stock is less than opening stock, the profit under absorption costing will be less as comparatively a higher amount of fixed cost contained in opening stock is debited during the current period.

**The features which distinguish marginal costing from absorption costing are as follows.**

- a. In absorption costing, items of stock are cost to include a 'fair share' of fixed production overhead, whereas in marginal costing, stocks are valued at variable production cost only. The value of closing stock will be higher in absorption costing than in marginal costing.
- b. As a consequence of carrying forward an element of fixed production overheads in closing stock values, the cost of sales used to determine profit in absorption costing will:
  - i. include some fixed production overhead costs incurred in a previous period but carried forward into opening stock values of the current period;
  - ii. exclude some fixed production overhead costs incurred in the current period by including them in closing stock values.

In contrast marginal costing charges the actual fixed costs of a period in full into the profit and loss account of the period. (Marginal costing is therefore sometimes known as period costing.)

- c. In absorption costing, 'actual' fully absorbed unit costs are reduced by producing in greater quantities, whereas in marginal costing, unit variable costs are unaffected by the volume of production (that is, provided that variable costs per unit remain unaltered at the changed level of production activity). Profit per unit in any period can be affected by the actual volume of production in absorption costing; this is not the case in marginal costing.
- d. In marginal costing, the identification of variable costs and of contribution enables management to use cost information more easily for decision-making purposes (such as in budget decision making). It is easy to decide by how much contribution (and therefore profit) will be affected by changes in sales volume. (Profit would be unaffected by changes in production volume).

In absorption costing, however, the effect on profit in a period of changes in both:

- i. production volume; and
  - ii. sales volume;
- is not easily seen, because behaviour is not analysed and incremental costs are not used in the calculation of actual profit.

### Limitations of Absorption Costing

The following are the criticisms against absorption costing:

1. You might have observed that in absorption costing, a portion of fixed cost is carried over to the subsequent accounting period as part of closing stock. This is an unsound practice because costs pertaining to a period should not be allowed to be vitiated by the inclusion of costs pertaining to the previous period and vice versa.
2. Further, absorption costing is dependent on the levels of output which may vary from period to period, and consequently cost per unit changes due to the existence of fixed overhead. Unless fixed overhead rate is based on normal capacity, such changed costs are not helpful for the purposes of comparison and control.

The cost to produce an extra unit is variable production cost. It is realistic to the value of closing stock items as this is a directly attributable cost. The size of total contribution varies directly with sales volume at a constant rate per unit. For the decision-making purpose of management, better information about expected profit is obtained from the use of variable costs and contribution approach in the accounting system.

### Summary

Marginal cost is the cost management technique for the analysis of cost and revenue information and for the guidance of management. The presentation of information through marginal costing statement is easily understood by all managers, even those who do not have preliminary knowledge and implications of the subjects of cost and management accounting.

Absorption costing and marginal costing are two different techniques of cost accounting. Absorption costing is widely used for cost control purpose whereas marginal costing is used for managerial decision-making and control.

#### Learning Objectives

- To understand the meanings of marginal cost and marginal costing
- To distinguish between marginal costing and absorption costing
- To ascertain income under both marginal costing and absorption costing