

Absorption vs Variable costing

Absorption Principles

- Includes **fixed manufacturing** overheads in inventory costing.
- Over-and Under Allocations are treated as **period costs**
- **Gross Profit** is shown in the income statement

Variable Principles

- **ALL Fixed Cost** are **expensed** when incurred.
- Used for **short-term** decisions
- **Contribution** is shown in the income statement

Strengths and weaknesses

- Inline with IAS2
- Long-term decisions
- Incorporates importance of fixed cost
- Deals with seasonality
- Profits can be manipulated over the **short term**

Strengths and weaknesses

- Shows irrelevance of fixed cost over the **short term**
- Profit = function of sales therefore valuable for **short term decisions**
- **Prevents** short term manipulation

