

- 4 Kevin runs a small manufacturing business. He is considering which method of inventory valuation he should use.

REQUIRED

- (a) State **two** advantages to a business of using **each** of the following methods of inventory valuation.

(i) First in first out (FIFO)

- 1
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- 2
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(ii) Last in first out (LIFO)

- 1
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- 2
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(iii) Average cost (AVCO)

- 1
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- 2
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Additional information

Kevin manufactures a single product and he intends to value his closing inventory at selling price which includes a mark-up on cost.

REQUIRED

(b) Explain why Kevin should not value his inventory at this price.

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Additional information

Kevin currently uses marginal costing but is considering changing to absorption costing.

The following budgeted information per unit is available.

	\$	
Selling price	20	
Direct material	6	
Direct labour	3	
Budgeted production	20 000 units per month	
Budgeted fixed overheads	\$100 000 per month.	

At 1 January there was no inventory held.

The following actual results are available for January and February.

	January	February
Sales (units)	15 000	21 000
Production (units)	18 000	18 000
Fixed overheads	\$100 000	\$100 000

REQUIRED

(c) Prepare the income statement for **each** of the months of January and February using marginal costing.

Kevin
Marginal cost income statement

	January		February	
	\$	\$	\$	\$
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(d) Prepare the income statement for **each** of the months of January and February using absorption costing.

Kevin
Absorption cost income statement

	January		February	
	\$	\$	\$	\$
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(e) Prepare a statement reconciling the marginal cost profit with the absorption cost profit for January.

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- (f)** Advise Kevin whether or not he should change from marginal costing to absorption costing. Justify your answer.

[7]