

# **TEACHING COST ACCOUNTING: DEVELOPING A PROBLEM FOR TRANSITIONING FROM THE ABSORPTION TO THE DIRECT INCOME STATEMENT**

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## **A B S T R A C T**

The absorption (or traditional) method of costing products views both variable and fixed costs of production as costs that should be inventoried if a product is not sold. Accordingly, each unit produced is assigned its variable production costs, plus each unit must also “absorb” its fair share of fixed overhead into its product cost which becomes an asset until sold. The direct (or variable) method of costing products views only the variable production costs as costs that should be inventoried if the product is not sold. In most cost accounting courses, the absorption method is presented first as part of financial accounting with the income statement and the statement of the cost of goods manufactured and sold. This is usually followed by a chapter on internal, cost-volume-profit analysis with its focus on direct costing. Students seem to have less trouble with either absorption or direct costing when each is discussed independently. However, the reason absorption and direct costing are usually in sequential chapters is so students can initially learn them separately, but then juxtapose them and work with them together and identify the differences. The problem in this presentation is designed to augment the transition from the absorption to the direct method. It is designed to be worked by students after both methods have been covered and a couple of shorter problems on each method have been separately worked.