

Problem 6-5A: Income reporting, absorption costing, and managerial ethics L.O. C2, P2, A1

Oshkosh Chemical produces and sells an ice-melting granular used on roadways and sidewalks in winter. It annually produces and sells about 100 tons of its granular. In its nine-year history, the company has never reported a net loss. However, because of this year's unusually mild winter, projected demand for its product is only 60 tons. Based on its predicted production and sales of 60 tons, the company projects the following income statement (under absorption costing).

Sales (60 tons at \$20,000 per ton)	\$ 1,200,000
Cost of goods sold (60 tons at \$15,000 per ton)	900,000
Gross margin	300,000
Selling and administrative expenses	318,000
Net loss	\$ (18,000)

Its product cost information follows and consists mainly of fixed cost because of its automated production process requiring expensive equipment.

Variable direct labor and material costs per ton	\$ 3,000
Fixed cost per ton ($\$720,000 \div 60$ tons)	12,000
Total product cost per ton	15,000

Selling and administrative expenses consist of variable selling and administrative expenses of \$300 per ton and fixed selling and administrative expenses of \$300,000 per year. The company's president is concerned about the adverse reaction from its creditors and shareholders if the projected net loss is reported. The operations manager mentions that since the company has large storage capacity, it can report a net income by keeping its production at the usual 100-ton level even though it expects to sell only 60 tons. The president was puzzled by the suggestion that the company can report income by producing more without increasing sales.

Prepare an income statement (using absorption costing) based on production of 100 tons and sales of 60 tons.
(Omit the "\$" sign in your response.)

OSHKOSH CHEMICAL
Income Statement

Sales	\$	<input type="text"/>
Cost of goods sold		<input type="text"/>
Gross margin		<input type="text"/>
Selling and administrative expenses		<input type="text"/>
Net income	\$	<input type="text"/>
