9. Flexible Budgeting

Conlon Ltd manufactures a component for the computer industry. The following flexible budgets have already been prepared for 60%, 75% and 90% of the plant's capacity:

Output levels	**60%**	**75%**	**90%**
Units	24,000	30,000	36,000
Costs	**€**	**€**	**€**
Direct materials	108,000	135,000	162,000
Direct wages	124,800	156,000	187,200
Production overheads	132,400	158,500	184,600
Other overhead costs	169,200	210,000	250,800
Administration overheads	40,500	40,500	40,500
	574,900	700,000	825,100

Profit is budgeted to be 20% of sales.

(a) **Required**:

(i) Separate production overheads into fixed and variable elements.

(ii) Separate other overhead costs into fixed and variable elements.

(iii) Prepare a flexible budget for 95% activity level using marginal costing principles, and show the contribution.

(b) Assume that Conlon Ltd is currently operating at 100% capacity and is considering two capital expenditure options costing €8,000 each as follows:

Option 1

Modernisation of machinery which will save €0.60 per unit in the production overheads.

Option 2

Buying new machinery which would increase the plant's capacity by 10% while reducing all fixed overheads (including administration) by 8%.

Required:

(i) Prepare flexible budgets, using marginal costing principles and showing contributions, for both options taking the new cost structures into account.

(ii) Advise the company on the best option.

(c) **Required**:

(i) Distinguish between the terms 'contribution' and 'profit'.

(ii) Outline why Conlon Ltd would prepare a flexible budget.

(80 marks)