FLEXIBLE BUDGETS

THEORY BOOKLET

STATE EXAM & DEB

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THEORY

STATE EXAM

Past Questions

1. What is meant by the term sensitivity analysis.
2. Outline why Henry Ltd would prepare a flexible budget. (10 Marks)

2021

3. Distinguish between contribution and profit
4. Outline why Conlon Ltd would prepare a flexible budget. (5 Marks)

2018

5. Explain, with examples, 'controllable' and 'uncontrollable' costs. (6 Marks)

2015

6. What is an adverse variance? State why adverse variances may arise in Direct material costs. (6 Marks)
7. Explain, with examples, 'controllable' and 'uncontrollable' costs. (6 Marks)

2006

SUGGESTED ANSWERS

2021

(c) (i) What is meant by the term sensitivity analysis.

1. Sensitivity Analysis is also known as 'what if' analysis.
2. It is a technique used by management accountants to show the effect on profit brought about by changes in the following:
    1. Selling price
    2. Sales volume
    3. Variable costs
    4. Fixed costs

The examples in part (b) of the question are examples of sensitivity analysis.

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

1. To show management the cost levels at different levels of production. It is misleading to compare the budgeted costs at one level of activity with the actual costs at a different level of activity.
2. To compare actual costs and budgeted costs at the same level of activity, in order to de termine if actual costs exceeded or were less than budgeted costs.
3. To compare budgeted costs and actual costs in order to identify variances. This allows corrective action to be taken.
4. To help in controlling costs or planning production levels.

2018

(c) (i) Distinguish between contribution and profit

Contribution This is sales revenue less variable costs. This goes towards paying off the fixed costs. Once the fixed costs are paid off, any further contribution goes towards profit.

Profit This is sales revenue less total costs (fixed and variable). It is the overall amount the business makes after taking to account all business costs

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

1. To show management the cost levels at different levels of production.
2. To compare actual costs and budgeted costs at the same level of activity.
3. To compare budgeted costs and actual costs in order to identify variances. This allows corrective action to be taken.
4. To help in controlling costs or planning production levels. It is misleading to compare the budgeted costs at one level of activity with the actual costs at a different level of activity.

2015

Controllable Costs

1. These are costs that can be controlled by the manager of a cost centre.
2. They will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs.

<u>For Example</u>

All variable costs are controllable. Commission to sales personnel can be controlled by the sales manager.

Uncontrollable Costs

1. These are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs.

<u>For Example</u>

Rates to the local authority are uncontrollable. As the local authority will set the rates and not the business

2012

(b) (iii) Explain, with examples, 'controllable' and 'uncontrollable' costs.

Controllable Costs

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For Example

Rates to the local authority are uncontrollable. As the local authority will set the rates and not the business

2006

(b) What is an adverse variance? State why adverse variances may arise in Direct material costs.

1. An adverse variance is where actual costs exceed budgeted costs (3)
2. An adverse variance in direct material costs may arise if the purchase price of materials is higher than expected or if the quantities of material used are higher than expected (3)

(c) Explain, with examples, 'controllable' and 'uncontrollable' costs.

Controllable Costs

1. Are costs that can be controlled by the manager of a cost centre.
2. She/he will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs.

For Example - all variable costs are controllable (3)

Uncontrollable Costs

1. Are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs.

For Example - rates to the local authority are uncontrollable

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DEB EXAM

Past Questions

1. Distinguish between 'contribution' and 'profit' (4 Marks)
2. Outline two differences in focus between Management and Financial Accounting

   (8 Marks)

   2023

3. Outline the differences between Marginal and Absorption Costing. Indicate which method should be used for financial accounting purposes and why. (10 Marks)

   2014

SUGGESTED ANSWERS

2023

Distinguish between 'contribution' and 'profit'. Any 2 (2 × 2 marks)

Contribution – is sales revenue less variable costs (1) - goes towards paying off fixed costs, once fixed costs are paid, any further contribution goes towards profit (1)

Profit – is sales revenue less total costs (1) - both fixed and variable costs (1).

Outline two differences in focus between Management and Financial Accounting.

Any 2: (2 × 4 marks)

1. Management Accounting Plans for the future (1) and provides information for planning and budgeting (1), whereas Financial Accounting records past events (1) in the form of a profit and loss account, balance sheet and cash flow statement (1)
2. Management Accounting has an internal focus (1) and provides information to aid planning and decision making (1), whereas Financial Accounting has both an internal and an external focus (1) and provides information to stakeholders such as managers, shareholders and creditors (1)
3. Management Accounting is not governed or restricted (1) by legislation or legal requirements (1), whereas Financial Accounting is governed and regulated (1) by both legislation and accounting standards such as FRSs (1)
4. Management Accounting prepares reports as often as managers require them (2), whereas Financial Accounting usually prepares reports once a year (2) // – Management Accounting prepares reports for cost-centres / departments (2), whereas Financial Accounting prepares reports about the whole business (2)

2014

Outline the differences between Marginal and Absorption Costing. Indicate which method should be used for financial accounting purposes and why. (10 Marks)

Difference (7) –

1. Different profit figure because closing stock is valued differently (1) – when costing a product, Marginal costing does not include fixed costs (1) whereas Absorption Costing does include fixed costs (1)
2. Closing stock is valued at a lower figure under Marginal Costing (1) because a share of fixed costs is included in the value of stock under Absorption Costing but not under Marginal Costing (1)
3. Under Absorption Costing, closing stock is valued at a $\frac{1}{4}$ of production costs of €32,400 whereas under Marginal Costing, closing stock is valued at $\frac{1}{4}$ of €47,400 (1)
4. The profit difference being €11,850 – €8,100 = €3,750 (1)

Method (1)

Absorption Costing

Reason (2)

It agrees with standard accounting practice (1) and matches costs with revenues (1).