**QUESTION 8**

**Marginal Costing**

**Break down of previous year questions Job Costing questions**

**2020 Marginal** and Absorption Costing

**2017 Marginal Costing**

**2014 Marginal** and Absorption Costing

**2011** **Marginal Costing**

**2008** **Marginal Costing** and separation of Costs

**2006** **Marginal** and Absorption Costing

**Past Exam Questions**

2020

1. (v) Explain what is meant by a step fixed cost and give an example.

 (4 Marks)

1. (ii)  Outline the differences between marginal and absorption costing.

 Indicate which method should be used for financial accounting purposes.

 Explain your answer.  (8 Marks)

2017

(f) What is meant by the term ‘Sensitivity Analysis’? (6 Marks)

2014

(b) (i) Outline the differences between Marginal and Absorption costing. Indicate

 Which method should be used for financial accounting purposes and why. (9 Marks)

2011

(f) (i) List and explain two limitations/assumptions of marginal costing.

 (ii) Explain what is meant by a step fixed cost. Roughly sketch a graph of step fixed

 Costs (5 Marks for the graph)

 (7 Marks)

2008

1. (v) For what purpose is the Contribution Sales Ratio regularly used? When is the use

 of this ratio essential? (2 Marks)

2006

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

**2020**

**Question**

1. (v) Explain what is meant by a step fixed cost and give an example.

1. (ii)  Outline the differences between marginal and absorption costing.

 Indicate which method should be used for financial accounting purposes.

 Explain your answer.

**Answer**

1. **(v) Explain what is meant by a step fixed cost and give an example.**

**Step fixed costs**

1. Step fixed costs are costs that are fixed within a certain range of activity but change outside of that range. [2]

For Example

Rent could be fixed up to a certain level of production. However, if production increases and results in the rental of more factory space, then the rent would increase to a new level. Thus, the fixed costs would increase in steps. [2]

1. **(ii)  Outline the differences between marginal and absorption costing.**

 **Indicate which method should be used for financial accounting purposes.**

 **Explain your answer.**

1. There is a different profit figure because closing stock is valued differently.
2. Marginal costing does not include fixed costs when costing a product whereas absorption costing does include the fixed costs.
3. Therefore, closing stock under marginal costing is valued lower than under absorption costing because a share of fixed costs is included in the value of stock under absorption costing but not included under marginal costing.
4. Under absorption costing, closing stock is valued at 20% of the production cost of €36,150. Under marginal costing, closing stock is valued at 20% of the production cost of €27,750. Closing stock under absorption costing is €7,230.
5. Closing stock under marginal costing is €5,550. This is a difference of €1,680.
6. The profit difference is €21,480 – €19,800 = €1,680

Absorption costing should be used as it agrees with standard accounting practice and concepts and matches costs with revenues.

**2017**

**Question**

(f) What is meant by the term ‘Sensitivity Analysis’?

**Answer**

**(f)** **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 (e) are examples of sensitivity analysis.

**2014**

**Question**

(b) (i) Outline the differences between Marginal and Absorption costing. Indicate

 Which method should be used for financial accounting purposes and why.

**Answer**

1. There is a difference in the profit figures because closing stock is valued differently.
2. Closing stock under marginal costing is valued lower than under absorption costing.
3. When costing a product, marginal costing does not include fixed costs whereas in absorption costing the fixed costs are included. Therefore a share of fixed costs is included in the value of stock under absorption costing and not included under marginal costing.
4. Under absorption costing,
* closing stock is valued at a 1/10 of the production cost of €19,000
* Under marginal costing, closing stock is valued at a 1/10 of the variable cost of €15,000

Closing Stock – Absorption Costing 1,900

Closing Stock – Marginal Costing (1,500)

Difference 400

1. The profit difference is 1 8,900 – 18,500 = 400

Absorption costing should be used as it agrees with standard accounting practice and concepts and also matches costs with revenues.

**2011**

**Question**

(f) (i) List and explain two limitations/assumptions of marginal costing.

 (ii) Explain what is meant by a step fixed cost. Roughly sketch a graph of step fixed

 costs

**Answer**

**(f) (i) List and explain two limitations/assumptions of marginal costing.**

1. Variable costs are assumed to be completely variable at all levels of output. However variable costs may decrease due to economies of scale or may increase because of increased costs.
2. It is assumed that in marginal costing fixed costs remain the same although most fixed costs are step-fixed and are only fixed within a relevant range.
3. It is assumed that all mixed costs are easily separated into fixed or variable.
4. The High Lo method can be used for this purpose but it is not always possible to do this.
5. It is assumed that the selling price per unit is constant and does not allow for discounts.
6. Production in a period usually equals sales. Fixed costs are charged in total to a period and are not carried forward to next period.

 **(ii) Explain what is meant by a step fixed cost. Roughly sketch a graph of step fixed**

 **Costs**

**Step fixed**

These costs are costs that are fixed within a certain range of activity but change outside of

that range

For example

Rent could be fixed up to a certain level of production. However, if production increases and

results in the rental of more factory space, then the rent would increase to a new level. Thus

the fixed costs would increase in steps

**2008**

**Question**

1. (v) For what purpose is the Contribution Sales Ratio regularly used? When is the use

 of this ratio essential?

**Answer**

**For what purpose is the Contribution Sales Ratio regularly used?**

The purpose of the Contribution Sale Ratio is to calculate the break-even point

**When is the use of this ratio essential?**

This ratio is used when the variable cost or selling price figures are not available

**2006**

**Question**

1. Outline the differences between Marginal and Absorption costing. Indicate which method should be used for financial accounting purposes and why.

**Answer**

1. **Outline the differences between Marginal and Absorption costing. Indicate which method should be used for financial accounting purposes and why.**
2. There is a different profit figure because closing stock is valued differently. Marginal costing does not include fixed costs when costing a product whereas absorption costing does include the fixed costs.
3. Therefore closing stock under marginal costing is valued lower than under absorption costing because a share of fixed costs is included in the value of stock under absorption costing but not included under marginal costing.
4. Under absorption costing, closing stock is valued at a ¼ of the production cost of 17,400 Under marginal costing, closing stock is valued at ¼ of the production cost of 14,400.
* Closing stock -Absorption costing 4,350
* Closing stock - Marginal costing (3,600)
* Difference 750
* The profit difference is 22,950 – 22,200 = 750

Absorption costing should be used as it agrees with standard accounting practice and concepts and matches costs with revenues.