

SECTION 3 (80 Marks)
Answer **ONE** question

8. Marginal and Absorption Costing

- A.** Harrington Ltd., produces a single product. The company's profit and loss account for the year ended 31/12/2005, during which 60,000 units were produced and sold, was as follows:

	€	€
Sales		720,000
Materials	288,000	
Direct labour	144,000	
Factory overheads	51,000	
Administration expenses	96,000	
Selling expenses	<u>68,000</u>	<u>647,000</u>
Net profit		<u>73,000</u>

The materials, direct labour and 40% of the factory overheads are variable costs. Apart from sales commission of 5% of sales, selling and administration expenses are fixed.

You are required to calculate:

- (a) The company's break-even point and margin of safety.
- (b) The number of units that must be sold at €13 per unit to provide a profit of 10% of the sales revenue received from these same units.
- (c) The profit the company would make in 2006 if it reduced its selling price to €11, increased fixed costs by €10,000 and thereby increased the number of units sold to 80,000, with all other cost levels and percentages remaining unchanged.

- B.** Cloud Ltd., produces 8,000 units of product Z during the year ended 31/12/2005. 6,000 of these units were sold at €6 per unit. The production costs were as follows:

Direct Materials	€0.50 per unit
Direct Labour	€0.80 per unit
Variable Overhead	€0.50 per unit
Fixed Overhead Cost for the year	€3,000

You are required to:

- (a) Prepare Profit and Loss statements under Marginal and Absorption costing principles.
- (b) Outline the differences between Marginal and Absorption costing. Indicate which method should be used for financial accounting purposes and why.

(80 marks)